

ORIGINAL



0000001133

RECEIVED

2004 MAR 18 P 4: 06

AZ CORP COMMISSION  
DOCUMENT CONTROL

Martin R. Galbut (#002943)  
Jeana R. Webster (#021387)  
GALBUT & HUNTER  
A Professional Corporation  
2425 East Camelback, Suite 1020  
Phoenix, Arizona 85016  
Telephone: 602-955-1455  
Facsimile: 602-955-1585  
E-Mail: mgalbut@galbuthunter.com  
Attorneys for Respondents Yucatan Resorts, Inc.,  
Yucatan Resorts S.A., RHI, Inc., and RHI, S.A.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS:**

**MARC SPITZER, Chairman**  
**WILLIAM A. MUNDELL**  
**JEFF MATCH-MILLER**  
**MIKE GLEASON**  
**KRISTIN K. MAYES**

In the matter of:

**YUCATAN RESORTS, INC., d/b/a**  
**YUCATAN RESORTS, S.A.,**

**RESORT HOLDINGS**  
**INTERNATIONAL, INC. d/b/a**  
**RESORT HOLDINGS**  
**INTERNATIONAL, S.A.,**

**WORLD PHANTASY TOURS, INC.**  
**a/k/a MAJESTY TRAVEL**  
**a/k/a VIAJES MAJESTY**

**MICHAEL E. KELLY,**

Respondents.

**DOCKET NO. S-03539A-03-0000**

**RESPONDENTS' JOINT MOTION  
FOR SANCTIONS**

**(ASSIGNED TO THE HONORABLE  
MARC STERN, ADMINISTRATIVE  
LAW JUDGE)**

Arizona Corporation Commission

**DOCKETED**

MAR 18 2004

DOCKETED BY

*Mac*

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22

### Introduction.

The primary focus of the March 4, 2004 pre-hearing conference was to address discovery and scheduling issues.<sup>1</sup>

As of that March 4 pre-hearing conference, the Division had not, with few involuntary exceptions,<sup>2</sup> produced documents or “evidence”, had not identified one actual intended witness (of which they say are 10 in number), and had not responded to any of Respondents’ requests to produce or interrogatories.

Moreover, at the pre-hearing conference, the Division’s attorney made the extraordinary -- and untrue -- statement that “there had been at least eight and probably more securities divisions across the country that have *issued rulings against the Respondents in this case. Clearly, they have found it to be a security . . .*” (emphasis added).<sup>3</sup>

The Division’s lawyer knew that this statement would be highly prejudicial and would cause ALJ Stern to be highly suspicious of Respondents and their business activities. Further, the Division’s lawyer made that statement to this tribunal in conjunction with a bold declaration at the outset of the pre-hearing conference that the Division has evidence of a “ponzi scheme on a national level.”<sup>4</sup>

As a result of these outrageous averments -- which have tainted these proceedings -- counsel for Respondents requested that ALJ Stern order the Division’s lawyer to produce the eight “rulings against Respondents” which he claimed supported his representations to the tribunal. ALJ Stern directed that the documents be produced to Respondents’ counsel.

---

<sup>1</sup> As a result of the ongoing and categorical refusal by counsel for the Securities Division to comply with the Division’s discovery and disclosure obligations, counsel for Respondents have been repeatedly requesting intervention.

<sup>2</sup> The exceptions are the identity of EUO examinations and related exhibits, which the ALJ had to order the Division to provide.

<sup>3</sup> See Reporter’s Transcript of Proceedings, p. 24, lines 9-13, Exhibit “1” hereto.

<sup>4</sup> See Reporter’s Transcript of Proceedings, p. 5, lines 4-6.

1        Upon inspection of those alleged “rulings”, it is obvious that the ballyhooed “rulings  
2 against Respondents” were wholly misrepresented.<sup>5</sup> Not a single one supports the bald  
3 allegation made at the hearing. Instead of eight “rulings against Respondents”, there is not  
4 one. Indeed, most of the so-called “rulings” did not mention or even relate to the Universal  
5 Lease, and many did not mention or even relate to any Respondents herein. Here is what – in  
6 fact – occurred in the other jurisdictions:

7        1.        **Kansas.**<sup>6</sup>

8        There are three documents from Kansas, filed June through August, 2003. The party  
9 named in the filings is Carl R. Todd, an individual that is not a Respondent in this action.  
10 Notwithstanding what the Division attorney represented, none of the Respondents *in this*  
11 *case* were Respondents in Kansas.

12        The first filing is a Notice of Intent to Invoke Administrative Sanctions Under the  
13 Kansas Securities Act. No formal action even commenced. The Notice states: “*If the facts*  
14 *alleged* below are found to be true, . . . it is the intention of the Commissioner to enter an  
15 Order imposing Sanctions upon the Respondent.” (Emphasis supplied).<sup>7</sup>

16        Next, the Securities Commissioner filed: (1) a Stipulation for Consent Order; and  
17 (2) a Consent Order, each prohibiting sales *by the agent only*, and making no mention of  
18 RHI or Yucatan. Contrary to the Division’s representations to this tribunal, there were no  
19 adverse findings of fact or law against RHI, Yucatan, Mike Kelly, or any other Respondent  
20

---

21        <sup>5</sup> The orders produced by the Division are attached as Exhibits “2” through “8”.

22        <sup>6</sup> See Exhibit “2”.

23        <sup>7</sup> The Notice involved an investigation into the Universal Lease Program, and alleged that,  
24 when offered in connection with another program (*i.e.*, the ESP program, not connected to  
25 RHI or Respondents), it violated Kansas securities laws. The Notice alleged that RHI  
26 acknowledged that the unauthorized program the agent offered was a security, but that RHI  
no longer offered those programs, and only authorized a program selling timeshares in  
Mexican resorts. According to the Notice, RHI had advised the Securities Commissioner  
that, because he had sold a program that was not authorized by RHI, the agent had been  
terminated.

1 in this action. Nor was there a finding that the Universal Lease Program itself was a  
2 security.

3 2. **Wisconsin.**<sup>8</sup>

4 There is a Petition for Order, and Order of Prohibition (Consent), filed in April  
5 2003. The party named is Yucatan Resorts, S.A. de C.V., which is *not* a party in this  
6 contested administrative proceeding.

7 There are allegations that the Universal Lease is a security, and that the money  
8 paid for the Universal Leases was used, in part, to repay investments sold by that entity.  
9 The matter was resolved by consent, *without admitting or denying the allegations*. In the  
10 Consent Order, the Division determined that, “it is not necessary under the circumstances  
11 that this order be grounds for disqualification pursuant to [Wisconsin securities laws] or  
12 that any exemption previously claimed by Yucatan Resorts S.A. de C.V. be denied” and  
13 that “[t]he Summary Order of Prohibition and Revocation issued against Yucatan Resorts  
14 SA de CV on April 2, 2001 is hereby revoked.” What occurred is contrary to the  
15 Division’s averments: there was no ruling against these Respondents following a contested  
16 hearing, or a determination that the Universal Lease Program itself was a security.

17 3. **Minnesota.**<sup>9</sup>

18 A Consent Cease and Desist Order was filed in February 2003 in Minnesota. The  
19 parties named were Resort Holdings International, Inc., Resort Holdings International,  
20 S.A. and Terry C. Denny (agent). In that Consent Cease and Desist Order, the Minnesota  
21 Commissioner of Commerce prohibited Respondents from offering or selling the alleged  
22 “securities”, and stated that the Commission was “prepared to commence formal action . . .  
23 based on allegations that Respondents . . . a) [o]ffered or sold unregistered securities . . . b)

---

25  
26 <sup>8</sup> See Exhibit “3”.

<sup>9</sup> See Exhibit “4”.



1 offered or sold subdivided land without registration . . . and, c) [the agent] offered or sold  
2 securities or subdivided land without licensure . . . .”

3 No formal action was commenced; it was an informal investigation. No adverse  
4 findings of fact or rulings against the Respondents in this case were issued. Rather, there  
5 was an agreement to an informal disposition of the matter, *without admitting or denying*  
6 *the allegations*. The Universal Lease Program was not found to be a security.

7 **4. Oklahoma.**<sup>10</sup>

8 The Oklahoma Order Initiating Investigation was issued in August 2001. The  
9 named target was “Yucatan Resorts” and two agents. The Order only initiated an  
10 investigation and is not, and cannot, be identified as an Administrative proceeding, action  
11 or “ruling.”

12 The Oklahoma Order identifies “Yucatan Resorts”, and merely announces the  
13 commencement of an investigation based upon allegations that “Respondents *may be*  
14 *involved in the offer or sale of securities in the State of Oklahoma.*” (Emphasis supplied).  
15 There was no hearing, no ruling, and no finding the Universal Lease Program was a  
16 “security”. There were no final adverse findings of fact or law of any kind.

17 **5. Connecticut.**<sup>11</sup>

18 Connecticut issued an Order to Cease and Desist, Notice of Intent to Fine and  
19 Notice of Right to Hearing in November of 2000. The party named is Yucatan Investment  
20 Corporation, which is *not* a Respondent in this instant action. The order does not relate or  
21 refer to the Universal Lease.

22 The order is a temporary cease and desist order, and it only makes allegations  
23 against Yucatan Investment Corporation based on the sale of promissory notes. The  
24 Universal Lease Program was not involved. There were no adverse findings of fact or law,  
25

26 <sup>10</sup> See Exhibit “5”.

<sup>11</sup> See Exhibit “6”.

1 and it is not a final ruling of any kind. There was no ruling against Respondents, or that the  
2 Universal Lease Program was a “security”.

3 **6. New Mexico.**<sup>12</sup>

4 In May of 1999, an Order to Cease and Desist and Notice of Intent to Impose  
5 Sanctions was issued in New Mexico against Yucatan Investment Corporation, Mike  
6 Kelly, and sales agents. Except for Mr. Kelly, the New Mexico Order did not involve the  
7 Respondents in this proceeding.

8 No formal post-hearing findings of fact or rulings were issued. Respondents in that  
9 case were ordered to cease and desist offering or selling promissory notes. There was no  
10 ruling relating to the Universal Lease.

11 **7. South Carolina.**<sup>13</sup>

12 There are two filings in South Carolina: (1) an Order to Cease and Desist, and  
13 Notice of Right to a Hearing; and (2) an Administrative Consent Order, filed in June and  
14 July 1999, respectively. The parties named were Yucatan Investment Corporation and  
15 Mike Kelly. Yucatan Investment Corporation is *not* a Respondent in this proceeding. The  
16 South Carolina Orders do not relate to, nor mention, the Universal Lease.

17 No hearing was held, and no findings of fact were made. The Order only alleges  
18 that the Respondents offered and sold promissory notes. The matter was resolved by  
19 Yucatan Investment Corporation and Mike Kelly consenting to entry of an Order. In the  
20 Consent Order, the Division stated, “In the course of the investigation, the Division  
21 determined that Yucatan, relying on improper advice from prior counsel, offered and sold  
22 unregistered securities in violation of the South Carolina Uniform Securities Act”, and  
23 “Following conversation with Respondent Yucatan, . . . Securities Division Staff and  
24 Respondent Yucatan agree the most appropriate resolution of the matter is to impose upon  
25

26 <sup>12</sup> See Exhibit “7”.

<sup>13</sup> See Exhibit “8”.

1 Respondent Yucatan, who denies any willful violation of law but desires to avoid the costs  
2 of a hearing and dispel any concerns of the Division, a \$20,000.00 fine and a requirement  
3 that the firm [cease and desist from the sales].”

4 The Division dismissed Mike Kelly from the case.

5 There was no hearing or ruling against the Respondents in this case that the  
6 Universal Lease Program was a security.

7 Contrary to the Securities Division’s representations at the March 4, 2004, pre-  
8 hearing conference, *not one of the seven* – not eight – “rulings” made findings that the  
9 Universal Lease was a security.

#### 10 I. Argument.

11 The documents produced by the Division’s counsel are not what they were represented  
12 to be. The documents were not rulings against the Respondents by even one jurisdiction -- let  
13 alone eight. Some were preliminary administrative decisions, which made no findings of fact  
14 or law following an evidentiary hearing of any kind. Further, many of them did not relate to  
15 the Universal Lease, the product that is at issue in this proceeding.

16 The Division’s lawyer made untrue statements to ALJ Stern, on the record. He cannot  
17 be allowed to make sweeping averments that are not true, or to disregard the most basic due  
18 process requirement that there must be evidentiary support for representations by counsel  
19 made in a legal proceeding to a tribunal. There is an ethical duty of candor toward the  
20 tribunal, and duties of fairness to opposing parties and their counsel.

21 The Division’s lawyer’s actions should be condemned in light of the Arizona Rules  
22 of Professional Conduct, A.R.S. § 12-349 and Ariz.R.Civ.P. 37(c). Each of these  
23 provisions allow for a lawyer to be sanctioned when his conduct so merits. This tribunal  
24 should impose appropriate sanctions on the Division.

25 ...

26 ...

1     **A.     Sanctions Are Appropriate Under the Rules of Professional Conduct.**

2         **1.     Duty of Candor to the Tribunal.**

3         A lawyer has a duty of candor toward a tribunal, and in that context, cannot  
4     knowingly make a false statement of a material fact (AZ-ER 3.3 (a)(3), ABA Model Rule  
5     3.3(a)(1)).<sup>14</sup> When an attorney makes an assertion of fact to the tribunal either through an  
6     affidavit or through asserting a fact in oral argument, the attorney is either expected to  
7     know that the assertion is true or to believe it to be true based on reasonable and diligent  
8     inquiry. AZ-ER 3.3 Comments [3]; ABA Model Rule 3.3.

9         In the hearing that took place on March 4, 2004, the Division's lawyer averred:

10                 There had been *at least eight and probably more* securities  
11                 divisions across the country *that has issued rulings against the*  
12                 *Respondents in this case.* Clearly, *they have found it to be a*  
13                 *security*, and we tend to prove it is a security. *We have*  
14                 *evidence to that effect.* (Page 24, lines 10-14). (Emphasis  
                    supplied).

15         The statements are demonstrably inaccurate and prejudicial. The Division's lawyer  
16     had no basis to make them. After the forced disclosure of the so-called "evidence", there  
17     was not one document that coincided with the Division's lawyer's outrageous remarks.  
18     The representations were not supported by the documents that were produced. Because he  
19     had presumably read the documents he referenced in his oral argument prior to the hearing,  
20     he must have knowingly made false statements of material fact to the tribunal. Even if his  
21     averments were a result of negligence and he did not knowingly make the false statements,  
22     then he and the Division had an obligation to promptly take reasonable remedial measures.

23         If a lawyer knows (or later learns) that the material evidence the lawyer has  
24     presented to the tribunal is false, then the lawyer has an *affirmative obligation* to take  
25     reasonable remedial measures. See AZ-ER 3.3(a)(3); ABA Model Rules 3.3(a)(3). The

---

26     <sup>14</sup> The ethical rules are found in Exhibit "9" (Arizona) and Exhibit "10" (ABA Model  
       Rules).

1 term "tribunal" includes all courts and other non-adjudicatory bodies -- such as this  
2 administrative proceeding. AZ-ER 1.0(m).

3 Subsequent to the making of the statements, all opposing counsel present at the  
4 hearing demanded evidentiary support for the outrageous allegations. For example, Mr.  
5 Galbut stated at the hearing that:

6 He says there are eight regulatory agencies that have already ruled  
7 on this. I'd like for him to turn over those orders to you today so you  
8 can see it there's eight agencies that have done that. And we would  
9 like to see them ourselves, because I think we're going to be a bit  
surprised on that subject. (p. 30, line 25 through p. 31, line 5).

10 The Division's lawyer was aware of the extreme offense taken by opposing counsel,  
11 which is evidenced in the transcript (See Page 6, lines 7-10 and Page 17, line 24 through  
12 page 18, line 12), and had in his possession the documents that he claims supported his  
13 representations. When ordered to do so, he subsequently disclosed the documents from  
14 other jurisdictions -- but they did not in any way support his statements. Respondents'  
15 counsels' expectations that we would be surprised if the Division's lawyer's  
16 representations were correct also served to put the Division's lawyer on notice of the  
17 falsity of the statements made. To this day, neither he nor the Division has not taken any  
18 remedial measure as required by the ethical rules, although the attorney is under an ethical  
19 requirement to do so.

20 **2. Duty of Fairness to Opposing Party and Counsel.**

21 It is grossly unfair to the Respondents and their counsel for the Division's attorney to  
22 make such unsupported and grossly prejudicial statements. This violates a further ethical  
23 duty.

24 Additionally, a lawyer must not unlawfully obstruct a party's access to evidence.  
25 AZ-ER 3.4(a); ABA Model Rule 3.4(a). Under a lawyer's duty of fairness to opposing  
26

1 party and counsel, a lawyer must make reasonable efforts to comply with the legally  
2 proper discovery requests made by an adversary. AZ-ER 3.4(d); ABA Model Rule 3.4(d).

3 Moreover, AZ-ER 3.4(d) provides that, during pretrial proceedings, a lawyer may  
4 not “fail to make a reasonably diligent effort to comply with a legally proper discovery  
5 request by an opposing party.” An attorney’s non-compliance with another party’s  
6 discovery request is a violation of AZ-ER 3.4(d) and warrants censure. *See In re Ames*,  
7 171 Ariz. 125, 829 P. 2d 315 (1992).

8 The Division’s lawyer has not made any reasonable efforts to comply with any  
9 discovery requests made by the Respondents. He has made highly prejudicial -- and  
10 demonstrably false -- statements to the tribunal. The Division’s lawyer is not treating the  
11 Respondents in accordance with the duty of fairness to opposing parties and counsel. The  
12 Division’s lawyer should be forced by ALJ Stein to abide by his ethical obligations.

### 13 **3. Special Responsibilities of a Lawyer in an Administrative Capacity.**

14 A government lawyer has the responsibility to develop a full and fair record. A  
15 lawyer in that role must not use his or her position or the economic power of the  
16 government to harass parties or to force unjust settlements or results.

17 The Division’s lawyer is operating as a government lawyer in an administrative  
18 capacity. He should be pursuing justice. Instead, he has made inflammatory assertions and  
19 claims that he cannot support with evidence.

20 Based on these ethical rules, he must timely disclose all evidence and information  
21 known that tends to demonstrate the liability, responsibility or guilt of the parties, or the  
22 absence thereof, and which is otherwise discoverable or disclosable. He has not done this  
23 in any way. He continues to make grossly prejudicial statements which are not supported  
24 by the evidence. He should be ordered to support his claims with evidence or to cease  
25 making these defamatory representations to the tribunal.  
26

1           **4. Duties of Candor and Respect in the Context of Administrative**  
2           **Proceedings.**

3           When a lawyer appears before an administrative body, the lawyer must follow the  
4           same rules as though he was in court. *See* ABA Model Rule 3.9. For example, a lawyer  
5           must not make false statements of facts or law, obstruct access to evidence, or knowingly  
6           violate the rules or orders of the administrative proceeding. *See* ABA Model Rule 3.9;  
7           3.3(a)-(c); 3.4(a)-(c); 3.5.

8           The Division's lawyer has made false and prejudicial statements to the tribunal, and  
9           has not met his affirmative obligation to take reasonable remedial measures. Additionally,  
10          the Division's lawyer has obstructed access to evidence. Unquestionably, the Division's  
11          lawyer is violating his duties in the context of this administrative proceeding.

12          **B. Sanctions Are Appropriate In Light of A.R.S. § 12-349 and Ariz.R.Civ.P. 37(c).**

13          Under A.R.S. § 12-349, sanctions may be imposed on the attorney or party for  
14          doing, *inter alia*, either of the following: (1) making a claim without substantial justification;  
15          or (2) engaging in abuse of discovery.<sup>15</sup> In this case, the Division's lawyer has done both: he  
16          has made claims without substantial justification, and engaged in abuses of discovery. He

17  
18          <sup>15</sup> A.R.S. § 12-349 provides:

19           A. Except as otherwise provided by and not inconsistent with another  
20           statute, in any civil action commenced or appealed in a court of record in  
21           this state, the court shall assess reasonable attorney fees, expenses and, at  
22           the court's discretion, double damages of not to exceed five thousand  
23           dollars against an attorney or party, including this state and political  
24           subdivisions of this state, if the attorney or party does any of the following:

- 25           1. Brings or defends a claim without substantial justification.
- 26           2. Brings or defends a claim solely or primarily for delay or harassment.
3. Unreasonably expands or delays the proceeding.
4. Engages in abuse of discovery.

\* \* \*

(emphasis added).

1 has made claims to ALJ Stern that were without justification, and he has continued to refuse  
2 the discovery and disclosure to which the Respondents are entitled.<sup>16</sup>

3 Rule 37(c), Ariz. R. Civ. P., provides for sanctions where an attorney or party makes  
4 a disclosure that he knew or should have known was inaccurate or incomplete and thereby  
5 causes an opposing party to engage in additional investigation or discovery. Rules 37(c)  
6 and 37(b)(2) provide for specific sanctions as well as any other ones appropriate under the  
7 circumstances. Rule 37(b)(2) allows the tribunal to, *inter alia*, issue an order refusing to  
8 allow the wrongdoing party to support or oppose designated claims, or prohibiting that  
9 party from introducing designated matters in evidence. In addition, these rules allow the  
10 tribunal to order the disobedient party or attorney to reimburse the opposing party for the  
11 costs, including attorneys' fees, of the investigation or other activities caused by the  
12 inaccurate disclosure.

13 The Division's lawyer has abused and violated his duties to this tribunal, and to  
14 opposing parties and their counsel. He has made inaccurate and untrue statements before  
15 this tribunal, which he boldly asserted without justification, in an apparent attempt to  
16 greatly prejudice the Respondents. The Division's lawyer apparently believes he has the  
17 right to act as judge and jury without regard to Respondents' legal rights. The Division's  
18 lawyer's misstatements to the tribunal (and refusal to provide discovery and disclosure)  
19 should not be ignored, and should instead be sanctioned.

20 ...

21 ...

---

23 <sup>16</sup> ALJ Stern has determined that Respondents are entitled to discovery in this case. Further,  
24 ALJ Stern has directed the Division and Respondents to work out discovery issues without  
25 his intervention. However, counsel for the Division had not produced any documents (with  
26 the exception of some EUO/deposition exhibits), until specifically ordered by ALJ Stern to  
produce the materials from other jurisdictions. Nothing else has been voluntarily produced,  
such as the so called "evidence" of a nationwide "Ponzi scheme".



1 **C. Sanctions Would Be Appropriate Under Rule 11 if the Representations by the**  
2 **Division's Counsel Had Been Made in a Filing.**

3 By analogy, the Division's lawyer's oral declarations would be cause for  
4 Ariz.R.Civ.P. Rule 11 sanctions if he had filed them in a pleading, brief or affidavit. Rule  
5 11 imposes an obligation on a lawyer to conduct an adequate investigation concerning any  
6 claim or legal position to be certain it is well-grounded before filing a document with the  
7 court. This investigation is what a professional, competent attorney would do in similar  
8 circumstances to satisfy the requirements of Rule 11. *See Standage v. Jaburg & Wilk, P.C.*,  
9 177 Ariz. 221, 866 P.2d 889 (Ct. App. 1993).

10 Rule 11 also imposes a duty upon a lawyer to review and reevaluate the factual  
11 position as a case develops. *See Gilbert v. Bd. of Med. Examiners*, 155 Ariz. 169, 745 P.2d  
12 617 (Ct. App. 1987). If investigation and discovery produce no facts in support of a claim  
13 or defense, an attorney may not be able to continue to press that claim. *Id.*<sup>17</sup>

14 In this case, the Division's lawyer obviously undertook no investigation to be  
15 certain that his declaration that "there had been at least eight and probably more securities  
16 divisions across the country that have *issued rulings against the Respondents in this case*" and  
17 that "[c]early, they have found it to be a security" was well-grounded in fact. Had he made  
18 such a misrepresentation in a writing in court, he would be subject to sanctions. The result  
19 should be no different when it is boldly made at a hearing in person before ALJ Stern.

20 **D. Preclusion of Evidence is An Appropriate Sanction in this Case.**

21 An appropriate sanction in this case is to preclude any argument, inference, or  
22 evidence relating to the administrative proceedings from other jurisdictions, the subject  
23 matter of any proceeding from another jurisdiction, or relating to the parties named in  
24 another jurisdiction. In essence, this sanction is similar to the granting of a motion in

---

25 <sup>17</sup> Further, a court has the inherent power to sanction bad faith conduct during litigation  
26 independent of the authority granted by Rule 11. *See Chambers v. NASCO, Inc.*, 501 U.S.  
32, 43, 49, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991).

1 limine, which is used in civil proceedings to enforce the discovery rules, and is effectively  
2 treated as a sanction against the infringing party. *See Jones v. Buchanan*, 177 Ariz. 410,  
3 868 P.2d 993 (App.1993).

4 **E. The Hearing Officer is Empowered to Impose Sanctions.**

5 The administrative rules of this State provide for the use of discretion by the  
6 Hearing Officer in allowing additional discovery, in excluding prejudicial or  
7 unsubstantiated evidence, and in exercising reasonable control over the conduct of the  
8 proceeding.<sup>18</sup> Rule 14-3-109(D) allows the presiding officer to “act upon any pending  
9 motions or applications.” Moreover, A.R.S. 41-1092.07 provides, in pertinent part:

10 D. All evidence is admissible, but the administrative law judge may  
11 exclude evidence if its probative value is outweighed by the danger  
12 of unfair prejudice [or] by confusion of the issues . . . .

13 In this case, the Division’s lawyer has made false and highly prejudicial  
14 representations about supposed administrative “rulings” and findings from other  
15 jurisdictions to the tribunal, which, upon inspection, directly refuted the Division’s  
16 averments. This tribunal should preclude any assertions of “rulings” or findings from other  
17 jurisdictions, and to any reference or the offering of evidence related to any proceedings in  
18 other jurisdictions by the Division’s lawyer at the hearing.

19 **III. Conclusion.**

20 The Division’s Attorney has violated basic ethical obligations to this tribunal, the  
21 opposing parties and their counsel. It has created very substantial prejudice to these  
22 Respondents. It has tainted these proceedings. The Division’s lawyer is an attorney in a  
23 governmental role, and is subject to the professional standards imposed by the Arizona  
24 Supreme Court on attorneys practicing in Arizona. He has violated his duties. The  
25 Division is responsible for its attorneys’ conduct.

26 <sup>18</sup> *See, e.g.,* A.R.S. 41-1092.07.

1 Accordingly, Respondents request that the Division be sanctioned by issuing an  
2 order with respect to the use of any proceedings in other jurisdictions, which order should:

3 (a) preclude the offering of any exhibit or other evidence of such alleged  
4 proceedings and any future proceedings or orders from any other jurisdictions;

5 (b) preclude any argument concerning or referencing the orders or so-called  
6 "rulings", the subject matter of the "rulings", or the parties named in the "rulings", and any  
7 future orders from any jurisdiction;

8 (c) admonish and prohibit the Division's lawyer from making any statements  
9 to ALJ Stern that are not true, or do not meet the requirement of candor to the tribunal,  
10 opposing parties and their counsel, pursuant to the Arizona Rules of Professional  
11 Responsibility or the requirement of Ariz.R.Civ. P. 11, so that before making any claim, he  
12 conduct a reasonable inquiry that the claim is well grounded in fact and law, and that it is  
13 not interposed for any improper purpose, such as, *inter alia*, to create further prejudice,  
14 bias, harassment or cause the needless increase in the cost of attorneys' fees in these  
15 proceedings; and

16 (d) require the Division to pay the reasonable expenses of this motion,  
17 including attorney's fees and costs, caused by the Division's disregard of his ethical  
18 obligations, which has compelled this motion for sanctions.

19 Dated this 18th day of March, 2004.  
20

21 GALBUT & HUNTER  
22 A Professional Corporation

23 By Martin R. Galbut *ju*  
24 Martin R. Galbut  
25 Jeana R. Webster  
26 Camelback Esplanade, Suite 1020  
2425 East Camelback Road  
Phoenix, Arizona 85016

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

and

BAKER & McKENZIE  
Joel Held  
Elizabeth L. Yingling  
Jeffrey D. Gardner  
2300 Trammel Crow Center  
2001 Ross Avenue – Ste. 2300  
Dallas Texas 75201  
Attorneys for Respondents  
Yucatan Resorts, Inc.; Yucatan Resorts, S.A.;  
RHI, Inc.; RHI, S.A.

and

ROSHKA HEYMAN & DeWULF, PLC  
Paul J. Roshka  
One Arizona Center  
400 E. Van Buren St. – Ste. 800  
Phoenix, Arizona 85004  
Attorneys for Respondent  
Michael Kelly

and

MEYER, HENDRICKS & BIVENS P.A.  
Tom Galbraith  
Kirsten Copeland  
3003 N. Central Ave. – Ste. 1200  
Phoenix, Arizona 85012-2915  
Attorneys for Respondent  
World Phantasy Tours, Inc.


ORIGINAL and 13 copies of the foregoing  
hand-delivered this 18th day of March, 2004 to:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007  
...  
...

1 COPY of the foregoing hand-delivered  
2 this 18th day of March, 2004 to:

3 Honorable Marc Stern  
4 Administrative Law Judge  
5 Hearing Division  
6 Arizona Corporation Commission  
7 1200 West Washington Street  
8 Phoenix, Arizona 85007

9 Jaime Palfai, Esq.  
10 Matthew J. Neubert, Esq.  
11 Securities Division  
12 Arizona Corporation Commission  
13 1300 West Washington Street, 3rd Floor  
14 Phoenix, Arizona 85007

15   
16 Jean R. Webster, Esq.  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

**EXHIBIT 1**

## BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF:

YUCATAN RESORTS, INC., dba

YUCATAN RESORTS, S.A.; et al.,

Respondents.

)

)

)

)

)

)

)

DOCKET NO.

S-03539A-03-0000

Prehearing Conference

At: Phoenix, Arizona

Date: March 4, 2004

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS**ARIZONA REPORTING SERVICE, INC.**

Court Reporting

Suite Three

2627 North Third Street

Phoenix, Arizona 85004-1126

Prepared for:

ACC

By: CECELIA BROOKMAN, RPR  
Certified Court Reporter  
Certificate No. 50154

1 BE IT REMEMBERED that the above-entitled and  
2 numbered matter came on regularly to be heard before the  
3 Arizona Corporation Commission, in Hearing Room 1 of said  
4 Commission, 1200 West Washington Street, Phoenix, Arizona,  
5 commencing at 10:00 a.m., on the 4th day of March, 2004.

6  
7 BEFORE: MARC E. STERN, Administrative Law Judge

8 APPEARANCES:

9  
10 For the Arizona Corporation Commission Securities  
Division:

11 Mr. Jamie B. Palfai  
12 Senior Counsel  
13 1300 West Washington Street  
Phoenix, Arizona 85007

14 For the Respondents Yucatan Resorts, Inc. dba Yucatan  
15 Resorts, S.A., and Resort Holdings International dba  
Resort Holdings International, S.A.:

16 GALBUT & HUNTER, P.C.  
17 By Mr. Martin R. Galbut  
18 and appearing telephonically, Mr. Jeffrey D. Gardner  
2425 East Camelback Road, Suite 1020  
Phoenix, Arizona 85016-4216

19 and

20 BAKER & MCKENZIE  
21 By Ms. Elizabeth Yingling  
22 2300 Trammell Crow Center  
2001 Ross Avenue, Suite 2300  
Dallas, Texas 75201  
(Appearing telephonically)

23

24

25



## 1 APPEARANCES:

2

For the Respondents Michael E. Kelly and Lori Kelly:

3

ROSHKA HEYMAN &amp; DEWULF, P.L.C.

4

By Mr. Paul J. Roshka, Jr.

One Arizona Center

5

400 East Van Buren, Suite 800

Phoenix, Arizona 85004-3902

6

7 For World Phantasy Tours, Inc.:

8

MEYER, HENDRICKS &amp; BIVENS, P.A.

By Mr. Tom Galbraith

9

3003 North Central Avenue, Suite 1200

Phoenix, Arizona 85001-2915

10

11

12

13

14

CECELIA BROOKMAN, RPR

15

Certified Court Reporter

Certificate No. 50154

16

17

18

19

20

21

22

23

24

25

1 ALJ STERN: This prehearing conference is now  
2 open in the matter of Yucatan Resorts, Incorporated, et  
3 al., in Docket No. S-03539A-03-0000. My name is Marc  
4 Stern. I'll preside over this proceeding today. And  
5 we'll now see who's here on behalf of the Division and the  
6 parties.

7 Okay, for the Division.

8 MR. PALFAI: Jamie Palfai on behalf of the  
9 Division.

10 ALJ STERN: And who is present on behalf of  
11 Yucatan and Resort Holdings International.

12 MR. GALBUT: Your Honor, Martin Galbut. Also  
13 with me are Jeana Webster and Keith Galbut law clerk, just  
14 recently took the Bar. And also we have on the telephone  
15 Elizabeth Yingling and Jeff Gardner.

16 ALJ STERN: Okay.

17 World Phantasy.

18 MR. GALBRAITH: Just me, Tom Galbraith.

19 ALJ STERN: Don't you need any reinforcements?

20 MR. GALBRAITH: I probably do, that may become  
21 evident as time goes on.

22 ALJ STERN: And for Mr. Kelly.

23 MR. ROSHKA: Paul Roshka, Roshka, Heyman &  
24 DeWulf.

25 ALJ STERN: With that, Mr. Palfai, what's the

1 status of the Division's proceeding? Are we getting close  
2 to setting a date on this case?

3 MR. PALFAI: Yes. Actually, I was just  
4 briefly discussing the matter with Mr. Galbut. We have in  
5 our possession evidence to suggest that this is a Ponzi  
6 scheme on a national level, and because of this, we want  
7 to push the hearing as quickly as possible and get a quick  
8 resolution in light of the evidence we have in our  
9 possession showing what this program in fact is. So we  
10 would urge that we could schedule a hearing date as soon  
11 as possible.

12 ALJ STERN: We might be able to do that in  
13 April.

14 MR. PALFAI: That would be fine.

15 ALJ STERN: If another matter of Mr. Roshka's  
16 goes off, if Mr. Roshka is available now.

17 MR. ROSHKA: I believe Mr. Roshka is  
18 available, but I don't know about the rest of counsel.

19 ALJ STERN: Well, Mr. Galbut's team has enough  
20 people they could probably do it seven days a week.

21 MR. GALBUT: Your Honor, could I just have  
22 five minutes and give you the full lay of the just to  
23 respond to this, because I think in order for you to  
24 understand where we really are, you really need the  
25 background.

1 ALJ STERN: Okay.

2 MR. GALBUT: Your Honor, first of all, this is  
3 the first conversation that we've had of this nature where  
4 you just heard these comments.

5 It's almost amusing, for the reason that we've  
6 been going through this process, and as I go through the  
7 discovery, what has occurred to date and what's happened  
8 in the discovery, you'll see the gross unfairness of their  
9 making a statement like this in a context like this, in  
10 light of discovery.

11 Now, first of all, they've only taken a few  
12 EUOs to date. There's another one which is scheduled the  
13 end of March. We need to know how many additional EUOs  
14 they are going to take, so that we can factor those into  
15 the schedule.

16 We have sent out document requests and  
17 interrogatories. The other respondents have sent that  
18 out. One of those was due yesterday. We haven't gotten  
19 the first piece of paper, not one single sheet of paper  
20 from the Division in connection with those document  
21 requests. We have not one single answer to any  
22 interrogatory. And the same is true for the other  
23 respondents. Theirs are coming up, due here in a little  
24 bit. But we can tell you that at this point in time, the  
25 Division has produced absolutely nothing to us.

1           Now, we talk about, okay, what depositions are  
2 we going to try and take. We tried to set up Mr. Higgs'  
3 deposition. Mr. Palfai wasn't responsive to the dates of  
4 Mr. Higgs' deposition that he proposed, and he responded  
5 to them after the date we proposed for Mr. Higgs'  
6 deposition. Mr. Higgs has now moved to Nevada, we  
7 understand, so we're going to have to take his deposition  
8 in Nevada, as well as starting to commence once we get the  
9 discovery responses from the Division, figuring out who  
10 the supposed complaining parties are, because so far as we  
11 know, there's no person who has asked for their money  
12 back, for example, who hasn't, in a reasonable period of  
13 time, received their money back. So as far as we know,  
14 there is no one out there who hasn't received their money  
15 back in a reasonable period of time after having made a  
16 request for it.

17           So once we get the discovery back we'll see  
18 who the supposed complaining parties are who claim that  
19 there's some kind of problem here where they need relief.

20           We need to take the deposition of a  
21 representative of the Commission. We need to take the  
22 deposition of the Securities Division's investigator. We  
23 need to take the depositions of those people who have been  
24 identified by the Division. And since the last hearing,  
25 we did this in an intelligent, straightforward way. We

1 sent all the discovery requests back. Zip in response.  
2 Now, they have a little bit of time on theirs, they've run  
3 out of time on ours, but we don't have that material in  
4 hand.

5 There were other EUOs they said they were  
6 going to take. We're not sure what's happened with them,  
7 John Donovan, Greg Rowe. We need to know how many more  
8 are on the table so that we can organize those and take  
9 those.

10 And we also need a statement on the record for  
11 Mr. Palfai as to whether other EUOs have been taken on  
12 this subject relating to these respondents that we don't  
13 know about. For example, in the Higgs EUO, they haven't  
14 given us the entire transcript. They heavily redacted it,  
15 and in areas which were obviously related to this case,  
16 they have redactions and they haven't turned over those  
17 additional parts of that transcript plus exhibits.

18 ALJ STERN: Who is Mr. Higgs? I don't know  
19 who he is.

20 MR. PALFAI: Mr. Higgs was a recruiter for the  
21 universal lease program. And we took his EUO before the  
22 whole discussion on the respondents in this case attending  
23 the EUOs, and we turned over the Higgs transcript as a  
24 courtesy, even though we weren't required to by the  
25 Commission order. We redacted portions we weren't going

1 to use in this trial that were not related to the case,  
2 but yet they're still complaining about it.

3 ALJ STERN: Is Mr. Higgs going to be called as  
4 a witness, do you anticipate?

5 MR. PALFAI: At this point, don't hold me to  
6 this, but probably not.

7 MR. GALBUT: Are they going to use his  
8 transcript in any way?

9 MR. PALFAI: Only portions that are not  
10 redacted.

11 MR. GALBUT: There you go. So yes, I mean, in  
12 some manner they're going to try and present some evidence  
13 from Mr. Higgs to the hearing. And if he's out of state,  
14 our only recourse is to go take his deposition in Nevada  
15 and to use his testimony in that way, because he's beyond  
16 the subpoena power to make him show up at the hearing in  
17 Arizona.

18 ALJ STERN: Mr. Palfai, I know the fact that  
19 people get their money back doesn't necessarily mean  
20 they're not complaining witnesses, but do you have names  
21 of complainants you're going to use in this case?

22 MR. PALFAI: You're right in describing  
23 complaining witnesses. In a Ponzi scheme there generally  
24 are not complaining witnesses till it collapses, as you  
25 know. We don't have any specific investors that we're

1 going to call at this point, but we'll be happy to provide  
2 that at the appropriate time.

3 I would just like to respond to --

4 MR. GALBUT: Mr. Chairman, could I just finish  
5 up then he can respond?

6 ALJ STERN: Yes, sir.

7 MR. GALBUT: We don't have a list of  
8 witnesses. We have no idea what a single witness is that  
9 they're going to call. Now, we asked for that in the  
10 interrogatories and request to produce. We have no idea  
11 who the witnesses are going to be.

12 ALJ STERN: When did you serve them on them?

13 MR. GALBUT: 40 days ago.

14 ALJ STERN: Mr. Palfai, when is the Division  
15 going to respond to Mr. Galbut?

16 MR. PALFAI: We intend to respond to all the  
17 attempted discovery requests sometime this week. Either  
18 today or tomorrow.

19 The problem with the discovery that the  
20 respondents in this matter have attempted to file with us  
21 is that they are following the civil rules of discovery,  
22 rules that do not apply in this administrative forum. And  
23 we are going to respond accordingly, and urge them to  
24 follow the administrative rules for discovery, so that we  
25 can wrap up this phase.



1           And as far as a witness and exhibit list, it's  
2   our belief that we routinely exchange those at a date  
3   prior to trial. Of course we'll comply with that order.  
4   Asking for witnesses and exhibits prior to the date that  
5   you order the exchange seems a little bit unnecessary.

6           ALJ STERN: Apparently they've been trying to  
7   do a little discovery, and they're not getting any  
8   response as such.

9           MR. PALFAI: One of the reasons we've been  
10   taking some time on this is we want to make sure that we  
11   adhere to the letter of the law as it applies to  
12   administrative discovery. We were very careful, we wanted  
13   to do all the research to make sure that our position on  
14   discovery is directly in line with the rules and statutes.

15          ALJ STERN: Okay.

16          MR. GALBUT: Your Honor, you have already  
17   ordered that the Rules of Civil Procedure apply to this  
18   case. That's how we got to the point where we are taking  
19   depositions and cross noticing.

20                 What you've just heard is the point of my  
21   argument in our situation which is we don't have a piece  
22   of paper, we don't have a single witness identified. He  
23   hasn't answered anything in a timely manner, and you know  
24   what, he just said he's not going to, because he's going  
25   to apply some administrative rule that says "I don't have

1 to respond to your discovery." And so as of when he does  
2 respond, we presume we're going to get very little, we're  
3 going to have objections that we have to come in and deal  
4 with before Your Honor.

5 Now, we're happy to handle all of these  
6 discovery issues on as expedited a basis as possible. But  
7 what has now happened is you have them, after they have  
8 languished in this proceeding and have gone forward on  
9 this discovery in slow motion, and been in absolutely no  
10 hurry, are now saying, "We want the hearing as quickly as  
11 possible, but we don't want to give you any identification  
12 of witnesses, we don't want to give you documents, we  
13 don't want to answer your interrogatories, we don't want  
14 to be helpful in the scheduling of depositions." And that  
15 is the situation that we are dealing with?

16 And the Higgs deposition is just an example.  
17 They're obligated to turn that over to us. They've  
18 heavily redacted parts that are obviously related to this  
19 case. They took EUOs where they went into those  
20 additional areas.

21 So, Your Honor, this is like a -- this is in  
22 no way a fair match that we're having. It's all one way  
23 and it's not two ways, as it has to be.

24 Now, when we get the material so we can move  
25 forward, get depositions lined up, hopefully we'll

1 cooperate with them on an expedited basis. We have no  
2 problem with that, we'll get the thing moving and we'll  
3 get it ready.

4 ALJ STERN: Who do you want to take  
5 depositions of from the Division?

6 MR. GALBUT: We will want to take, like a Rule  
7 30(b)(6) deposition, a representative of the Division.  
8 They can designate whoever they like, who has knowledge of  
9 this case.

10 Number two, we want to take the deposition of  
11 the investigator.

12 Number three, we want to take the deposition  
13 of any complaining parties and people who they have  
14 interviewed, investigated and so on, of which we have no  
15 clue who they are, because they've never disclosed any of  
16 those names or discovery requested that. But we don't  
17 know who any of them are as of this point in time, and we  
18 want to take the depositions of anybody that they are  
19 identifying as a potential witness in this case.

20 So until we have the documents, records,  
21 answers to interrogatories, we're shooting in the dark as  
22 to who these people are, because as far as we know, there  
23 are no complaining parties. Maybe there are. And if so,  
24 we've got to find out what their story is so that we can  
25 move forward and take their depositions.

1           Now, we have no problem, once this discovery  
2 comes back, it doesn't matter to us if we do it next week,  
3 where we come back to you and say if we're right, gee,  
4 Your Honor, we told you what was going to happen, they  
5 haven't given us a thing, we're still where we were a week  
6 ago, we can do it in 30 days. We're happy to have you in  
7 the middle of these sets of discovery issues in order to  
8 expedite this proceeding. We don't have any problem with  
9 that whatsoever. And then, when it happens, that we  
10 really do get what we're entitled to, fine, we'll go  
11 forward, we'll schedule a hearing, we'll have the hearing.

12           I can tell you another thing that's happening  
13 here, Your Honor, just to lay out the whole context of  
14 this. This matter doesn't even belong here in the first  
15 place. We've been taking this position all along, with  
16 all due respect to Your Honor. It doesn't belong here.  
17 It's a time share. It belongs over at the Real Estate  
18 Department. Now, you don't only have to take our word for  
19 it. The Real Estate Department has issued subpoenas and  
20 has interviewed witnesses in this case as well.

21           And so there's this whole question of subject  
22 matter jurisdiction that's been floating around. It has  
23 not yet been brought to a head, but it's an issue which is  
24 out there, and we would also like the opportunity at some  
25 point to present that issue to you as the, essentially the

1 court of first impression, because Your Honor always has  
2 the ability of saying look, I don't have subject matter  
3 over this, it's the Department of Real Estate. So we  
4 think that's an issue that ought to be briefed. We could  
5 brief it on an accelerated basis if that's what Your Honor  
6 requires.

7               So Your Honor, we don't have a problem with a  
8 fair fight. What we do have a problem with is a situation  
9 where we've got two agencies that are working hand in  
10 glove in the state government, so there's a lot of  
11 duplication which has taken place, and a lot of  
12 cooperation that we're not privy to, and then a completely  
13 one-sided way of proceeding with this matter.

14              It all started when they filed this, got the  
15 temporary cease and desist, essentially put the client out  
16 of business in the State of Arizona, so there's no  
17 compelling, urgent need to do anything. They're  
18 effectively out of business here, and have been in  
19 connection with complying with Your Honor's order.

20              Then it turns out they didn't have the factual  
21 basis to do what they did, so they said oh, we're going to  
22 now start taking EUOs, then we came back and said wait a  
23 minute, the discovery rules apply and Your Honor's  
24 essentially agreed with that, and formulated a way of  
25 dealing with the EUO process, which as far as we can tell,

1 maybe it's close to being finished on their end, maybe  
2 there's another 10 people they're thinking of. We've had  
3 various numbers at every one of these hearings about how  
4 many people we're going to take examinations under oath  
5 of, and if there's another five or ten coming -- we know  
6 there's at least one -- they have to be taken, they have  
7 to be cross noticed, and we need to get the material so we  
8 can start defending on the case. So we know who it is,  
9 what it is, what the documents are, who the witnesses are  
10 and so on, so we can be prepared for a hearing.

11 MR. PALFAI: Mr. Stern, if I could jump in  
12 here and address some of these elements.

13 ALJ STERN: Were you done?

14 MR. GALBUT: Yes, sir. Thank you, Your Honor.

15 MR. ROSHKA: Mr. Stern, could I be heard  
16 before Mr. Palfai jumps in?

17 ALJ STERN: You might as well respond.

18 MR. GALBUT: Your Honor, I'll just add as we  
19 try to figure out the scheduling, and we checked with  
20 Mr. Held's schedule as well, we thought the last week of  
21 October, the first two weeks of November would be  
22 realistic.

23 ALJ STERN: They're gone. Mr. Roshka has  
24 them.

25 MR. GALBUT: We'll try and work around some

1 other dates that work there. But hey, the fact of matter  
2 is that I can assure you we've been moving it along. We  
3 have received less than perfect cooperation from the  
4 Division in terms of discovery responses and providing us  
5 what we're entitled to.

6 So what they would like to do now as of this  
7 morning, a few minutes before Your Honor walked in, is to  
8 cry emergency, we have to have the hearing immediately.  
9 And oh, by the way, we're sorry, we don't have to answer  
10 any of your discovery or do anything else to let you  
11 prepare for your defense. That's grossly unfair.

12 Thank you, Your Honor.

13 MR. ROSHKA: Just two points. One, Mr. Palfai  
14 did make a pretty bold statement when we went on the  
15 record today, and I'd just like to remind everyone that  
16 this is a case that began as a temporary order to cease  
17 and desist, and I'm not aware of any suggestion there's  
18 been a violation of that order, which I understand  
19 continues as of this moment. I really don't understand  
20 the urgency Mr. Palfai is suggesting that you need to be  
21 concerned about, given the existence of that order. There  
22 is some discovery to be taken in this case that has not  
23 yet been taken, as you just heard.

24 And then, secondly, that bold statement that  
25 he made, that he has evidence as of today of some sort of



1 national scheme, and without reminding Mr. Palfai that  
2 he's an Arizona lawyer representing the citizens of  
3 Arizona, and Arizona only, where a temporary order to  
4 cease and desist continues as of this moment, I'd like you  
5 to order him to produce every piece of paper, every  
6 document, every shred of evidence that he has today to  
7 back up that statement. And he can do that simply by  
8 contacting a copy service, they can make the appropriate  
9 number of copies for counsel, and we can have that  
10 so-called evidence today or perhaps tomorrow, depending  
11 upon the copy service's schedule, and I'm sure counsel  
12 will be glad to pay for that copying charge.

13 ALJ STERN: Okay. And I guess Mr. Galbraith  
14 is coming in now.

15 MR. GALBRAITH: I actually do have a little  
16 bit to say.

17 I have repeated reminders now of the fact that  
18 I'm getting older, and one of them is that when I heard we  
19 have evidence of some atrocity mentioned, in a way that  
20 reminded me of I have in my briefcase the names of 400  
21 known Communists that's working in the state department,  
22 that really struck a kind of Pavlovian chord with me. I  
23 think I'm mixing my metaphors.

24 In any case, I would hope and assume that one  
25 doesn't make scheduling orders based on somebody saying



1 they've got some secret evidence. It seems to me if  
2 somebody has shocking and important evidence to present to  
3 a tribunal, the way you do it is you present that evidence  
4 and then you make your arguments from there.

5 ALJ STERN: Okay, thank you.

6 Mr. Palfai.

7 MR. PALFAI: Well, there are several issues  
8 I'd like to address. Mr. Galbut suggested we're operating  
9 under the civil rules of discovery, and that comes as a  
10 shock to me. We are not in a civil forum, we're in an  
11 administrative forum, and I would ask the court to affirm  
12 the fact that we are operating under the rules of the  
13 Corporation Commission and not under the rules of civil  
14 discovery. We never agreed to the civil rules, and they  
15 necessarily don't apply. We will be citing statute and  
16 rules to that effect.

17 ALJ STERN: Anything else?

18 MR. PALFAI: Oh, yeah, I have plenty.

19 ALJ STERN: Okay, yeah.

20 MR. PALFAI: Did you comment that we're now  
21 operating under civil rules?

22 ALJ STERN: No. The operation that Mr. Galbut  
23 and you were speaking of, that essentially I outlined was  
24 something to make it a little bit more fair with the EUO  
25 process, so that the respondents' counsel, who wanted an

1 opportunity to be able to examine your witnesses that you  
2 were calling, or your -- the individuals who are being  
3 examined under oath, they could at least cross-examine  
4 them in the way that they could. Now, I assume that  
5 process has been ongoing at least since the last time we  
6 talked about it.

7           The other issues with respect to  
8 interrogatories I wasn't aware of, since usually they're  
9 put to parties in a proceeding in a civil case, as such,  
10 but not necessarily an administrative proceeding to an  
11 agency, division. That would be something unusual. I  
12 haven't seen them in this area, but the securities area is  
13 a little different than the utilities area that the  
14 Commission also regulates. But they do have what they  
15 call data requests in the utilities area that are put to  
16 the Staff in rate cases and other proceedings so that  
17 there's sort of an exchange of information going back and  
18 forth.

19           Now, I don't know whether the Division takes  
20 the position you're not liable to -- not subject to this  
21 type of a procedure since there are procedures that the  
22 Commission does follow in its other activities. Maybe in  
23 a proceeding under the criminal -- under the statutes in a  
24 criminal format you wouldn't be subject to some of this  
25 discovery, but I believe you are subject to some discovery

1 in the criminal forum also. The book just isn't closed.

2 MR. PALFAI: It's the Division's understanding  
3 that this special arrangement with the EUOs is a one-time  
4 thing to expedite these proceedings.

5 ALJ STERN: It's certainly not been done  
6 before and it probably won't always be done in the future.

7 MR. PALFAI: Absolutely not. And that  
8 certainly is not equivalent to saying we agree to all the  
9 rules of civil discovery. This is a one special thing to  
10 accommodate the respondents. It wasn't a suggestion that  
11 we're now operating under a different set of rules.

12 I will file later this week a response to the  
13 discovery request very clearly pointing out what are the  
14 appropriate types of discovery in administrative  
15 proceedings, and there's explicit wording in the Arizona  
16 Revised Statutes rejecting the civil rules.

17 ALJ STERN: Is that under the Administrative  
18 Procedures Act?

19 MR. PALFAI: No. It's actually under Section  
20 41-1062.

21 ALJ STERN: That is the Administrative  
22 Procedures Act, I believe. I think what you just cited, I  
23 think is where it falls.

24 MR. PALFAI: Okay. But there's also  
25 Commission rules that go -- that touch on discovery and

1 statutes. So the combination of those outlines the entire  
2 scope of discovery in administrative forums. If we can  
3 just follow the rules, then some of these interrogatories  
4 that are floating in are just completely inappropriate.  
5 So I will address that later this week, and I'll get you a  
6 copy of that, you can consider that.

7 As far as the depositions that the respondents  
8 wish to do, they can certainly depose witnesses from the  
9 Division that will be testifying. We have no problem with  
10 that. We'll be happy to schedule those in the next few  
11 weeks, whenever they're --

12 ALJ STERN: How many Division witnesses do you  
13 envision from the Division?

14 MR. PALFAI: Two to three.

15 ALJ STERN: Like an accounting witness, an  
16 investigator, I assume, and another one?

17 MR. PALFAI: And maybe an expert on investment  
18 contracts.

19 ALJ STERN: That's from the Division?

20 MR. PALFAI: Yes.

21 ALJ STERN: And do you have any investor  
22 witnesses you intend to call?

23 MR. PALFAI: Absolutely. We don't know them  
24 by name now, but we will have a few.

25 As far as the response opposing those

1 witnesses, I don't think that's necessary. It will just  
2 be harassing the witnesses, intimidating the witnesses.  
3 They're not going to gain any salient information deposing  
4 those witnesses. I think that will be unnecessary.  
5 Obviously they're trying to create the impression it will  
6 take months and months to get discovery, when in fact we  
7 can have this done in three to four weeks.

8 MS. YINGLING: We're having difficulty hearing  
9 Mr. Palfai. How many witnesses did he say the Division  
10 thought they would have?

11 ALJ STERN: Possibly three from the Division.

12 MS. YINGLING: Did he say that he was not  
13 going to give us any documents in response to our request  
14 for production, or he was going to give us documents?

15 ALJ STERN: There's going to be, apparently  
16 from what Mr. Palfai seems to intimate at this time, a  
17 filing being made by the Division with respect to the  
18 request for --

19 MR. PALFAI: To all four requests for  
20 production and interrogatories this week.

21 ALJ STERN: This week. I guess that doesn't  
22 leave us too much time since today is Thursday. So by the  
23 end of tomorrow you're going to be making a filing --

24 MR. PALFAI: Correct.

25 ALJ STERN: -- and/or providing the

1 information they've requested?

2 MR. PALFAI: Correct.

3 Just on Mr. Galbut's comment that they were  
4 due yesterday, he's again using the civil rules as a  
5 timetable. The civil rules are governing all the  
6 discovery requests, the timetables, and obviously they're  
7 inapplicable. So they mean very little.

8 Touching on the comment that this matter  
9 belongs in the Department of Real Estate, there had been  
10 at least eight and probably more securities divisions  
11 across the country that have issued rulings against the  
12 respondents in this case. Clearly, they have found it to  
13 be a security, and we tend to prove it is a security. We  
14 have evidence to that effect. And until you hear the  
15 evidence surrounding this case, I don't know how you can  
16 make a ruling that it belongs in a different forum.

17 ALJ STERN: Look, with respect to that claim,  
18 Mr. Galbut, if your client wants to get the Commission  
19 knocked off from pursuing them, there's two ways to do  
20 that. Since you think it's a real estate matter, go to  
21 court or defeat the Division at this level, I guess on  
22 their allegations on the temporary notice. I don't know  
23 how else to do it.

24 I think you could possibly seek a court order  
25 restraining the Commission from pursuing an action, but I

1 don't know what would happen in that respect because of  
2 the real estate action, but that's up to you. You and  
3 your client.

4 MR. PALFAI: One other issue I wanted to touch  
5 on, I believe Mr. Roshka alluded to that we're here to  
6 protect Arizona citizens and since it's a national, we  
7 believe it may be a national scam, that we shouldn't be  
8 concerned with that, we should just focus on Arizona.  
9 Since the business in Arizona has almost completely shut  
10 down, there's no urgency.

11 I would suggest that because we now have  
12 evidence to suggest it is a Ponzi scheme, there is an  
13 immediate necessity to get to the bottom of this case and  
14 see if we can get restitution before the money disappears.  
15 And I know we have April, a portion in April, a couple  
16 weeks in April that have recently opened up, and I think  
17 that would be a perfect time to put this case, slot this  
18 case in. We can complete all the discovery that's  
19 necessary under the rules and by statute, under the  
20 Administrative Procedures Act, and there's no reason why  
21 we can't go forward unless the other side wants to delay  
22 and drag this out as long as possible so that they can  
23 disappear into the night, without compensating any of the  
24 Arizona investors.

25 ALJ STERN: Okay.



1 MR. ROSHKA: Mr. Stern.

2 ALJ STERN: Yes, sir, Mr. Roshka.

3 MR. ROSHKA: I guess if eight or ten agencies  
4 around the country have issued orders, that means 40 to 42  
5 have not.

6 And I think also, I'd like to renew my request  
7 for this titillating evidence of this allegation that  
8 apparently he has in his possession. I'd like to ask that  
9 you order it be produced today, and that copies be  
10 distributed to counsel. It's a serious allegation he's  
11 made. To me it expands the scope of this case. If  
12 anything, it may now require us to retain experts to  
13 address these issues. I again urge you, given these  
14 statements, if he has evidence today, that he produce it  
15 today.

16 MS. YINGLING: If I may make a statement about  
17 that as well. Mr. Palfai's statement is outrageous,  
18 offensive. If it were made in front of a jury, it would  
19 require a mistrial. Here he's claiming that he has  
20 evidence of some national scam. He claims that there's  
21 evidence of eight states issuing orders and yet we asked  
22 for basic documents in a request for production, documents  
23 that were due to be turned over yesterday, we got nothing.

24 We're getting played. He's playing a game.  
25 This isn't a game. He comes in each time and makes



1 outrageous statements, and yet when we ask for the support  
2 to those statements, we get nothing. For him to come in  
3 today and make such an outrageous claim, without anything  
4 to back that up, and then to demand that this matter  
5 proceed to a hearing next month is absolutely outrageous  
6 and absurd and absolutely denies respondents of due  
7 process.

8 ALJ STERN: We're going to see that you get  
9 due process, no matter what.

10 MR. GALBUT: Thank you.

11 ALJ STERN: You're entitled to due process.

12 With respect to the Division's claims, they  
13 have the burden of proving any of their allegations. I  
14 don't believe in the original temporary notice, temporary  
15 order and notice of opportunity for hearing, there was an  
16 allegation of a Ponzi scheme, but perhaps their discovery  
17 has gone towards that direction. We'll wait and see what  
18 the evidence produces on that, in that regard.

19 In any event, anything else, Mr. Palfai, that  
20 you wanted to respond?

21 MR. PALFAI: Well, this is a prehearing  
22 conference. The reason I bring this up, this Ponzi scheme  
23 notion, is because I want to urge this court to go ahead  
24 and have a hearing on the matter and resolve this matter  
25 as quickly as possible.

1 ALJ STERN: Okay.

2 MR. PALFAI: That's the point. I'm not here  
3 to shock Ms. Yingling, I'm hear to have a hearing on this  
4 matter.

5 ALJ STERN: Do you have anything else to say  
6 with respect to the comments by Mr. Galbut earlier?

7 MR. PALFAI: With reference to?

8 ALJ STERN: Complainants, no one's unhappy,  
9 they're getting their money back if they ask for it,  
10 et cetera, et cetera.

11 MR. PALFAI: Right. And to that I would  
12 submit there's no need for depositions of those  
13 individuals.

14 ALJ STERN: How many complaining witnesses do  
15 you anticipate if you're almost ready to proceed with  
16 this?

17 MR. PALFAI: Maybe three or four.

18 ALJ STERN: So you're not talking, in terms of  
19 the number of witnesses in this case I think we're talking  
20 like seven or eight people max?

21 MR. PALFAI: Maybe 10. And at a time of day  
22 where we schedule exchange of witnesses and exhibits,  
23 everything will be laid out, like in other administrative  
24 proceedings.

25 ALJ STERN: If you were going to have a

1 hearing in April you'd have to probably put forth your  
2 list of witnesses and copies of exhibits probably a month  
3 ahead of time.

4 MR. PALFAI: That would be fine.

5 ALJ STERN: You're saying you're just about  
6 ready to go to court at this point.

7 Mr. Galbut.

8 MR. GALBUT: Thank you, Your Honor. And I  
9 very much appreciate Your Honor's comments about due  
10 process, and we know that you mean that.

11 Your Honor, I think you just hit on another  
12 point when you said wait a minute, I'm not even sure this  
13 Ponzi scheme is in this complaint or amended document,  
14 which has been filed. So what we're supposed to do now is  
15 defend a case that hasn't even been presented to the  
16 Commission or to the respondents on short notice.

17 Now, presumably, this type of case, were it to  
18 be pled at some appropriate time, and appropriate  
19 responses there are going to require accounting experts.  
20 We haven't talked to an accounting firm because we have no  
21 idea what he's talking about, and we would have to hire  
22 accountants in order to appropriately respond to that, if  
23 that's the kind of case he's saying it now is as of this  
24 date.

25 We would presumably need some experts in the

1 field of Ponzi schemes to distinguish our situation from a  
2 Ponzi scheme. We need an expert on the question of  
3 whether this is a time share or a security. He's saying  
4 he has such experts.

5 Now, thank you, Your Honor, for getting out of  
6 him how many witnesses there are going to be. We very  
7 much appreciate if you also got out of him today who they  
8 are. Tell us who the 10 witnesses are so that we can  
9 notice their depositions. We are entitled to do that.

10 Now, Your Honor, we have presented to the  
11 court, and we've done this before in other hearings,  
12 R14-3-101.A, procedures governing these proceedings. And  
13 they specifically say that the Rules of Civil Procedure as  
14 established by the Supreme Court of the State of Arizona  
15 govern, where there's nothing else covering the topic.  
16 There's no prohibition against requests to produce,  
17 there's no prohibition against interrogatories. It's a  
18 logical and sensible way to get information out of an  
19 agency that won't give us the first bit of information.  
20 Who is the witness? Where are your documents?

21 Mr. Roshka's request is entirely appropriate,  
22 and Your Honor should order it today, that he produce the  
23 records today, tomorrow, the next day, within a week that  
24 supposedly support this emergency.

25 He says there's eight regulatory agencies that

1 have already ruled on this. I'd like for him to turn over  
2 those orders to you today so you can see if there's eight  
3 agencies that have done that. And we would like to see  
4 them ourselves, because I think we're going to be a bit  
5 surprised on that subject. So he's, I hate to say it,  
6 very fast and loose with the facts and with the procedures  
7 that we're supposed to be going through in this case.

8           What he's just told you today is that he is  
9 ignoring the Rules of Civil Procedure, and they're going  
10 to say, like they have before, to avoid responsibilities  
11 to make disclosure, which is their obligation, to make  
12 disclosure, to provide discovery, to be candid. They're a  
13 government agency. They've got to turn stuff over. They  
14 haven't turned over a thing.

15           What he's going to do is file something, if he  
16 gets around to it, this week, although it's late under the  
17 rules, that's going to say we thumb our nose at you again,  
18 we're not giving you a piece of paper, we're not telling  
19 you who our witnesses are, we're going to wait a month  
20 before so you can't take anybody's deposition, and you're  
21 not going to get any discovery for this proceeding.  
22 You're going to go in there cold, not knowing what this  
23 case is about, because, oh, by the way, we just changed  
24 the nature of the case today to a different kind of a  
25 case, and we're not going to give you any of it. And if

1 you don't like it you've got to come back to Mr. Stern to  
2 adjudicate whether our crummy, unjustified objection holds  
3 any water so that we're further delayed in getting the  
4 documents, the identification of witnesses that we are  
5 absolutely entitled to.

6 And the only way we're going to get it, Your  
7 Honor, is if you order it, because apparently we're not  
8 going to see it any other way, and that's the only way  
9 that we can get our side of the case going. And the rules  
10 of the Division specifically provide for it. They  
11 specifically adopt the Arizona Rules of Civil Procedure.

12 And when the court -- when Your Honor was  
13 considering the discovery, the depositions in this case,  
14 you said in the prehearing conference on October 7,  
15 Mr. Stern, the administrative rules apply as far as they  
16 do go. They don't apply where they don't speak to it.  
17 Then you went on to say all right, anyway, we're splitting  
18 hairs here. What's investigation, what's discovery, if  
19 the discovery is going to lead to evidence that's going to  
20 be used in this case. I'm sorry, they should have a  
21 chance to be there. That's just the way I look at it.

22 So Your Honor has been endeavoring to get us  
23 due process. I can tell you that the message is not being  
24 heard by the Division. We're not getting it.

25 Now, I think the simple way of starting to

1 deal with it today is make them tell Your Honor who the  
2 witnesses are so we can get it, go about starting to  
3 depose them.

4 Make them turn over the evidence which they  
5 claim they have. There should be no reason for delay in  
6 that. Everyone wants a speedy hearing. Fine, at least  
7 we'll get the evidence. This idea of eight divisions  
8 doing this in other places, make them turn over all these  
9 orders that he says exist out there.

10 Your Honor, on this question of what do we do  
11 about this lack of subject matter jurisdiction, we're  
12 going to go back and give Your Honor's comments some  
13 thought on that. But a judge such as Your Honor is always  
14 in a position to question his own jurisdiction, say  
15 whether it belongs here or whether it belongs over in  
16 another agency. Every judge, administrative law judge or  
17 otherwise, is always empowered to ask whether he has  
18 jurisdiction over a case, and if this is the time share,  
19 it doesn't belong here.

20 And then Your Honor asked the question what  
21 about this, our comments about we're the complaining  
22 parties here. Mr. Palfai didn't answer it, he said this  
23 is a national scheme, but really we ought to focus on  
24 Arizona. Fine, we focus on Arizona, it turns out there's  
25 no complaining parties so far as we know, and that it's



1 not an ongoing Ponzi scheme. We know that too because he  
2 said hey, we know that the activities are not occurring in  
3 this state.

4 So what we have, then, are a bunch of comments  
5 which are meant to inflame and prejudice Your Honor's view  
6 of the case as much of what has happened here without any  
7 beef. And whenever we say let's see the beef, we never  
8 see it, we never see an ounce of it.

9 So, Your Honor, I believe there are some  
10 remedial things the court can do today to move this case  
11 along. Name the witnesses, tell us who those witnesses  
12 are going to be, tell us what your case is, is it now a  
13 Ponzi case or the case that we all thought it was until we  
14 walked in here this morning. Turn over the documents.  
15 Forget this objection business; we have a right to the  
16 documents so that we can move forward. Make a decision on  
17 whether we can take depositions of the people that they  
18 identify as witnesses. We expect that everybody that  
19 we're going to identify as a witness, they're going to  
20 have the ability to take the deposition of. It's a  
21 two-way street; we recognize that.

22 And so, Your Honor, I think that in this  
23 instance, we have to do more than just talk about do due  
24 process in the abstract. In light of what's happened we  
25 think we need some very concrete decisions from Your



1 Honor. Thank you.

2 ALJ STERN: Mr. Galbraith, did you have  
3 something?

4 MR. GALBRAITH: I did. I'm uncommonly  
5 loquacious this morning. There's just a fundamental  
6 disconnect here that's going on with the Division. On the  
7 one hand, the Division comes in here today and asks you to  
8 set an accelerated hearing on a matter that's been pending  
9 for a long time. And on the other hand, they don't do the  
10 things that facilitate a fast hearing.

11 If you want speed, then you turn everything  
12 over. If you want to add a new issue, you file a motion  
13 with your evidence and ask to add the new issue. And you  
14 file affidavits for why we need an accelerated hearing.  
15 You don't wander in and say, having lolligagged and not  
16 responded to discovery requests for a long time, now all  
17 of a sudden, put the metal to the pedal or the pedal to  
18 the metal, whatever way it is. And that's what we've got  
19 here. If you want speed, you should do the things that  
20 entitles you to it, and they haven't. And they have not  
21 even indicated a willingness to do it.

22 What we're going to have a fight, apparently,  
23 when they do get around to filing responses to outstanding  
24 discovery requests about whether their positions are  
25 appropriate and what we're entitled to.

1           Now, if they were being consistent in their  
2 positions, the moment that they wanted real speed, the  
3 moment they got requests for documents that they think are  
4 inappropriate, they would have filed something saying so.  
5 So there's just this fundamental disconnect, and the fact  
6 of the matter is that they haven't done the things that  
7 should entitle them to the sudden acceleration they've  
8 asked for in these proceedings.

9           ALJ STERN: Mr. Palfai, any further comments?

10          MR. PALFAI: Yes, I do have some comments. We  
11 first need to address this misinterpretation of 14-3101  
12 that Mr. Galbut was speaking of. The provision he speaks  
13 of, the sentence states: In all cases in which procedure  
14 is neither set forth by law nor these rules or regulations  
15 nor orders of the Commission, Rules of Civil Procedure  
16 shall apply. The discovery rules are explicitly set forth  
17 in agency rules, and by law being the statute.

18          So to cite to this provision, to say that all  
19 sort of discovery is fair game, that's nonsense. This is  
20 referring to procedures that are not addressed by agency  
21 rule or statute. That doesn't apply here because we have  
22 both a statute and agency rule to test our discovery.

23          ALJ STERN: I tell you what, I have to agree  
24 with Mr. Galbraith here. The Division wants a fast  
25 hearing all of a sudden. All during this procedure things

1 have been going fairly slowly. I don't think you're going  
2 to get as fast a hearing as you want, but it isn't going  
3 to be delayed to any great extent either.

4               However, I want the Division -- at this point  
5 in time I've heard enough of the arguments. I want the  
6 Division to file its objections to the requests for  
7 documents, the interrogatories, the depositions, whatever  
8 they are, whatever your objections are, I want you to file  
9 them, get them filed by tomorrow at the latest, and copies  
10 made available or faxed to the respondents so they can  
11 file their response to your objections. I'll make a  
12 ruling, we'll see where we're at at that point in time,  
13 and how soon you can get this stuff finished up.

14               Because the Division is essentially saying  
15 we're ready to go, we're adding a new allegation, but we  
16 haven't filed a motion to add it. I don't know whether  
17 you have to, particularly at this point, because it is an  
18 administrative proceeding. However, the burden of proof  
19 is on you in any event to prove whatever evidence you  
20 have.

21               If the respondents need additional time to  
22 respond in the form of a defense, then at the conclusion  
23 of your proceeding, whatever time they need, I've always  
24 been fairly liberal in that respect, to secure a witness  
25 or to secure whatever response there is. We can make

1 arrangements for that.

2 But beyond, to have this case go on for three  
3 years with arguments over when we're going to see the  
4 evidence, and so with that, can you get your objections  
5 filed tomorrow?

6 MR. PALFAI: Absolutely. As I stated earlier,  
7 they will be filed by the end of the week.

8 ALJ STERN: That's tomorrow.

9 MR. PALFAI: All four sets.

10 ALJ STERN: Anything else?

11 MR. PALFAI: Yes, there are several things I'd  
12 like to address.

13 ALJ STERN: Okay.

14 MR. PALFAI: Mr. Galbut also suggested that  
15 he's entitled to depositions of all our witnesses. That's  
16 not the case under the rules for administrative  
17 proceedings. It's within the discretion of the court to  
18 grant respondent the right to depose a witness. So he's  
19 again reverting to civil rules that have no applicability  
20 here, and I would urge him to look at the correct rules in  
21 pursuing his discovery.

22 Several of the attorneys here today for  
23 respondents have asked for a list of the witnesses so they  
24 can start their depositions, or a list of exhibits so they  
25 can see what evidence. Of course we're going to produce

1 that. We'll produce that at a time and date designated by  
2 you when we exchange list of witnesses and exhibits.  
3 That's always been done here, and of course we'll comply  
4 with that. And we would like to get that date set as soon  
5 as possible, and we'll give them our list of witnesses and  
6 exhibits and they can have all that information.

7 This notion that we've been going slow and  
8 that we're going fast is inconsistent. The reason why the  
9 need for speed at this point is because we've uncovered  
10 evidence to suggest that there's a Ponzi scheme at play  
11 here, and that the investors of Arizona are at high risk.  
12 And that discovery has only occurred recently, so that's  
13 why the sudden urge for, need for urgency, is because of  
14 this new evidence that's come to light only recently.

15 So to say that we're being inconsistent, we  
16 only got this evidence within the last two weeks and that  
17 is why we need -- that's why we're asking you to speed  
18 this process up. We're not playing games here.

19 I have a couple other things.

20 MR. ROSHKA: Mr. Stern.

21 ALJ STERN: Let him finish.

22 MR. ROSHKA: All right.

23 MR. PALFAI: I will defer for now.

24 ALJ STERN: Mr. Palfai, you allege that there  
25 have been certain jurisdictions, I think Mr. Roshka

1 pointed out, I think you mentioned eight or so. I think  
2 that's a matter of public record, and if you would perhaps  
3 just ease this process along a little further and perhaps  
4 you could provide them or spell out what jurisdictions  
5 have found that these -- I know you'll put in certified  
6 copies of the orders from the other.

7 MR. PALFAI: We do in fact already have  
8 certified copies of all those jurisdictions.

9 ALJ STERN: Maybe you'll perhaps provide those  
10 copies to the respondents so there's no question in their  
11 mind that certain other jurisdictions have filed  
12 violations of their securities act. I don't think there's  
13 any big secret to that, they already know about it if they  
14 don't believe you.

15 MR. PALFAI: They would obviously be exhibits  
16 they would get copies of at the time of the --

17 ALJ STERN: They'd certainly get them then,  
18 but if it's possible to --

19 MR. PALFAI: Absolutely.

20 ALJ STERN: Okay, that would resolve that  
21 matter, at least initially, so we don't have any question.  
22 Mr. Roshka --

23 Are you done, Mr. Palfai?

24 MR. PALFAI: Yes.

25 ALJ STERN: Mr. Roshka.

1 MR. ROSHKA: Mr. Stern, we think it's fair to  
2 say we didn't know we'd be defending an allegation  
3 involving this recently discovered evidence, and I'd like  
4 to again renew my request that you order him to produce  
5 this recently discovered evidence to us immediately so  
6 that we can have an opportunity to begin the evaluation of  
7 the basis for his statement to you earlier this morning.

8 ALJ STERN: Yes, sir, Mr. Galbut.

9 MR. GALBUT: Yes, Your Honor, I'll be very  
10 brief. Your Honor, in light of what's happened we would  
11 like the court to order that on a date fixed by the court,  
12 the Securities Division file an amended pleading which  
13 sets out what they believe is the claim in this case so  
14 that we can defend against it. And when you -- as the  
15 court knows, when you allege fraud, that it's a Ponzi  
16 scheme, it has to be alleged with particularity, and we're  
17 entitled to that. And the administrative rules do deal  
18 with amendments, and he should be ordered to set forth the  
19 grounds with particularity for the claim which they are  
20 now presenting so that we can appropriately defend that  
21 claim. That's number one.

22 Number two, Your Honor, we would request that  
23 you order the Division to provide us with a list of  
24 witnesses, including lay and expert witnesses, and a list  
25 of exhibits at a date which Your Honor sets. The sooner



1 the better.

2           You know, Your Honor, what he said is we have  
3 the evidence. They have it, fine, turn it over. It's a  
4 matter of copying it; that's easy, we can get that  
5 accomplished. What they have must be turned over  
6 immediately.

7           And they must present a list of witnesses, lay  
8 and expert, and their list of exhibits so that we can come  
9 back to you and say okay, here is the list of witnesses,  
10 here's how we intend to do this, here's who our witnesses  
11 are going to be.

12           We can't exchange witness and exhibit lists.  
13 We don't know what their case is, we don't know who their  
14 witnesses are, we haven't seen the first document. We  
15 can't provide a list of witnesses and exhibits. It's an  
16 impossibility at this point in the proceeding.

17           So number two, we need a date that the court  
18 sets for a witness and exhibit list. He says he can do it  
19 next week, make it next week. That will speed things up,  
20 give us 30 days to respond to it. And the only reason we  
21 need that additional time is we need to look at all the  
22 evidence, see what's there, decide if we need expert  
23 witnesses, get those expert witnesses engaged, come up  
24 with a list of witnesses and exhibits on our own. But we  
25 need that. That's a necessary first step.



1           We can delay that inevitably, but every time  
2   it's delayed we'll be back here saying the same thing that  
3   we've said today and which we've said before and which  
4   we've tried to resolve by sending out interrogatories,  
5   requests to produce that says who are your witnesses, who  
6   has complained; identify these people for us, what are  
7   they going to say.

8           And so, Your Honor, under these circumstances,  
9   the stall should be off. They need a date in which they  
10   have to comply, or it isn't going to happen and we're  
11   going to be in the same pickle at a later date.

12           Mr. Roshka's request, number three, he says a  
13   Ponzi scheme is at play here. They've got documents two  
14   weeks ago, he said they have the evidence. They have the  
15   evidence, they need an order to turn it over because  
16   apparently they're not going to do it voluntarily. They  
17   must turn over the evidence which they say they have.  
18   That's number three.

19           We appreciate Your Honor's point on the  
20   certified copies that they have which they haven't turned  
21   over. We're anxious to see them, because we don't think  
22   that they say what Mr. Palfai says they say.

23           So Your Honor, I think at this point,  
24   respectfully, there have to be specific orders here.  
25   That's the way this thing is going to get going. Absent

1 those specific orders, it isn't going to get going. What  
2 we're going to do is he's going to file his objection next  
3 week, we're going to file a response, we're going to  
4 request a hearing on these discovery issues, we're going  
5 to be back here in 30 days, talking about the same things  
6 we've talked about today and he still hasn't turned over  
7 any documents, he still hasn't told us who his witnesses  
8 are, we still can't schedule anything, we still can't  
9 schedule a hearing. We'll be exactly where we are 30 days  
10 from now.

11 So, Your Honor, the only thing we're asking  
12 for here is to turn over evidence they now have, turn over  
13 a list of witnesses where they can identify every person's  
14 name today. He counted them. Three here, three there,  
15 add four, we've got ten. Give us the name, tell us what  
16 they're going to testify about, give us some addresses.  
17 We are entitled to know who those people are.

18 Absent that, we are clueless as to what his  
19 case is. We cannot defend, we do not get due process.  
20 And, Your Honor, I think that's -- we respectfully submit,  
21 we need those specific directions, otherwise it ain't  
22 going to happen. Thank you.

23 ALJ STERN: Mr. Palfai, any further comments?

24 MR. PALFAI: Yes, I do have a couple further  
25 comments. To suggest they don't know what our case is, I

1 would just suggest that they read our temporary order to  
2 C&D, because all our allegations are contained in that  
3 document.

4 ALJ STERN: Not the one concerning the Ponzi  
5 scheme that's been raised.

6 MR. PALFAI: I wanted to address that. The  
7 Ponzi scheme is not a separate allegation. The Ponzi  
8 scheme will be shown in the context of the other fraud  
9 counts. It's part and parcel of the evidence to show that  
10 it's a security, and evidence of the various fraud counsel  
11 allege. There's no need for an amended complaint. We  
12 didn't allege a Ponzi scheme in the amended temporary  
13 order, but the evidence that a Ponzi scheme is in fact  
14 occurring will be presented as part of the case.

15 ALJ STERN: I guess what you're saying in  
16 effect is that what we've seen previously here at the  
17 Commission in terms of some of these investments, the  
18 latter investors are being used to pay off people who were  
19 in the investment earlier. Is that what's happened?

20 MR. PALFAI: That's right. And also the Ponzi  
21 scheme will show the pooling of assets, the commonality  
22 component in the investment contract and go to show that  
23 it is in fact a security. That's part of the entire case.  
24 It doesn't need a separate allegation.

25 ALJ STERN: Before I make any additional

1 rulings on turning over witness names and copies of  
2 exhibits --

3 MR. PALFAI: Mr. Stern.

4 ALJ STERN: Yes.

5 MR. PALFAI: I'm sorry to interrupt. I just  
6 wanted to address a couple of other points that Mr. Galbut  
7 brought up.

8 He's asking for witnesses and exhibits. In an  
9 administrative proceeding such as this, we exchange  
10 witnesses and exhibits at a date and time that you order  
11 prior to the hearing. I believe it's usually 30 days  
12 prior to hearing, and that's the custom that we follow  
13 here.

14 ALJ STERN: It is and it isn't. I mean, when  
15 someone requests information in many of your cases, that's  
16 the Division's cases with respondents. Some counsel don't  
17 really request it because they know there is a complaining  
18 investor or investors.

19 In this case, there's a lot of investors, and  
20 they may not be particularly aware of who is going to be  
21 called that will testify about their investment. I don't  
22 know how many Arizona investors there are in this  
23 particular proceeding, and involved with this particular  
24 offering. And maybe there were 500. Well, if you're only  
25 going to call four of them, who are they? How can I

1 prepare to defend myself if I don't have a clue as to who  
2 it is.

3 MR. PALFAI: I believe that's the purpose of  
4 presenting the witness and exhibit list sometime before  
5 trial, so that they have an opportunity to do what they  
6 need to do.

7 ALJ STERN: Well, it certainly helps when you  
8 have an allegation or you have somebody who's going to  
9 testify that you have a little bit more time than 20 to 30  
10 days. Usually, on those witness lists and copies of  
11 exhibits that we have parties exchange, usually it's two  
12 to three weeks. That's not ample time, normally. Usually  
13 there's some exchange of information that's gone on, or  
14 the case isn't so overly broad that people have a general  
15 idea, if they're the respondent, who is going to be  
16 testifying against them. They're going to know that the  
17 Division is going to call a certain accountant. They  
18 don't know who, but in some cases, no one wants to go to  
19 the expense of taking these people's depositions.

20 Here you have a respondent who wants to spend  
21 a few bucks and will see what the witness might say about  
22 their transactions. So it's a little different in this  
23 respect. Usually, you don't have somebody who's going to  
24 do that. These respondents are willing to go a little bit  
25 further. So we have to deal with them on that basis.

1 MR. PALFAI: Then perhaps 30 days is a little  
2 short and we can extend it to 45 days.

3 ALJ STERN: It might have to be. Yes. What I  
4 want, and like I said before, I want the Division's  
5 objections filed by tomorrow. The respondents, you can  
6 have your 10 days, I guess you get a little extra time, as  
7 Mr. Roshka pointed out to me once, because you use the  
8 mail, you get another five. Then I guess if you want to  
9 file a reply, you get another five, but that will be it,  
10 no more.

11 And like I say, I want to see why you're  
12 saying no, we're not going to give them this until you put  
13 out an order setting a hearing, and setting exchange of  
14 witness list and exhibits. Because sometimes I've seen in  
15 these cases where people just give me a list of witnesses  
16 and a list of exhibits, and I don't see the exhibits. I  
17 think the Division's always been good about it, but the  
18 respondents in the past have not filed the information.

19 MR. PALFAI: That's fine. It's not actually  
20 an objection, but it's a response to their request for  
21 interrogatories and production of documents. That will be  
22 filed by the end of this week.

23 ALJ STERN: Okay. After I get that then I'll  
24 make a ruling and/or we may have oral arguments, although  
25 I prefer not to, I've heard enough already. And I'll just

1 make a decision on it.

2 Do you have something else?

3 MR. PALFAI: No, I just --

4 ALJ STERN: I'm not going to set a hearing  
5 date today.

6 MR. PALFAI: Okay. I just wanted to respond  
7 to Mr. Roshka's request for us to open up our  
8 investigative file so he can look through.

9 ALJ STERN: Yes, sir.

10 MR. PALFAI: That's not how administrative  
11 proceedings work. Obviously, we have a lot of  
12 confidential information, we have a lot of information  
13 protected by investigative privilege. That's why there's  
14 specific rules for administrative proceedings, which I  
15 will cite in my response, and hopefully once you read  
16 that, you will agree that the civil rules of discovery  
17 have no place in this room.

18 ALJ STERN: Okay. Thank you. That's pretty  
19 much it. Once I get that information, I will put out a  
20 procedural order with respect to your objections and the  
21 position of the respondents. We'll schedule another  
22 prehearing conference probably in a little over 30 days,  
23 but I don't know when till after I look at the objections,  
24 et cetera.

25 The matter of the -- is it eight states?



1 MR. PALFAI: Approximately.

2 ALJ STERN: Whatever, those, you provide to  
3 the respondents. If they're not aware of them, I'm  
4 surprised, but that's something, if you have certified  
5 copies, you can certainly turn over. That's public  
6 record.

7 MR. PALFAI: That won't be a problem.

8 ALJ STERN: That's no big secret.

9 What else? Anything else that you could think  
10 of?

11 MR. PALFAI: Mr. Stern, I understand you're  
12 not going to set a hearing date today, but have you  
13 considered any dates?

14 ALJ STERN: I have some openings coming up  
15 after April that I think we can -- if it's the Division's  
16 position that you're only going to be talking perhaps on  
17 the outside 10 witnesses, I don't know how many the  
18 respondents are going to call to rebut your allegations.  
19 In many of these cases, there's no one that takes the  
20 stand, or in the alternative, if they have 10 witnesses  
21 we're still not talking -- you know, it's not going to be  
22 as long a hearing as I originally thought.

23 MR. PALFAI: And we could curtail that witness  
24 list even further, if necessary.

25 ALJ STERN: That's why I say. With that --



1 MR. ROSHKA: Mr. Stern.

2 ALJ STERN: Yes, sir, Mr. Roshka.

3 MR. ROSHKA: I seem to be becoming a one-issue  
4 guy today with regard to this so-called evidence regarding  
5 the Ponzi scheme. Are they going to be providing that to  
6 us?

7 ALJ STERN: I imagine there's going to be some  
8 sort of accounting summary in their exhibits. I don't  
9 know what they are -- the basis is to support that. Many  
10 of the times we have securities hearings that I've sat  
11 through and it shows ultimately that investors that were  
12 receiving a return on their investment or whatever, this  
13 is in the case where there was fraud, for instance, were  
14 getting perhaps moneys from other investors who invested  
15 at a subsequent date. This happens.

16 Now, I don't know whether or not you can  
17 classify that as a full blown Ponzi scheme in this  
18 instance, because it might be they might have some new  
19 accounting records. I don't know where it went.

20 MR. ROSHKA: I don't know what they have  
21 either, but it's apparently, according to Mr. Palfai, a  
22 national operation, which suggests to me it's pretty big,  
23 and must be very voluminous, and I'd like to order them to  
24 produce the documents upon which he based his statement  
25 today that he possesses evidence of a Ponzi scheme.

1 ALJ STERN: Why don't you put it in writing to  
2 them in a request of production of documents or something,  
3 or interrogatories or some such document, and let him  
4 include it in his objections and for what reasons.

5 MR. GALBUT: Your Honor, that's all covered in  
6 there, whatever his allegations are. We ask for the  
7 evidence, we ask for the proof.

8 Your Honor, forgive me for being so direct,  
9 but I am perplexed by your reluctance to order him to turn  
10 the evidence over. He says he has the evidence, he's made  
11 these statements to you. Why wait 30 days? Why wait 60  
12 days?

13 You know, Your Honor, here's what we're really  
14 entitled to. We're really entitled to an amended pleading  
15 which sets forth this claim. Just as these gentlemen  
16 said, we're entitled to his doing that. Absent that, Your  
17 Honor should order him to give you and give us a writing  
18 which lays out what this supposed claim is.

19 Number two, he says we have the evidence.  
20 Fine, I don't know if it's a box, two boxes, a file  
21 folder. Whatever it is, we are entitled to it right now.  
22 There's no reason for that not to be turned over.

23 And Your Honor, I just don't think,  
24 respectfully, that we move anything along unless we get  
25 that. Once we get it, we're not interested in a summary,

1 we're interested in the documents. We're going to have an  
2 accountant, I presume. We'll find one. We'll go out and  
3 get an accounting expert who's an expert in this field to  
4 review those documents to see if they reach the same  
5 conclusion as the Securities Division. That takes months  
6 to accomplish a task like that, to get the records, bring  
7 in an accountant, have an accountant review it during tax  
8 season or shortly thereafter, prepare a report so that you  
9 have an expert for a hearing. Why would that be delayed  
10 30 days, Your Honor? I respectfully submit that should be  
11 turned over. He says he has it, we're entitled to it, we  
12 believe we should have it now.

13 Thank you, Your Honor.

14 MR. PALFAI: Quickly respond to that. The  
15 respondents are not entitled to that. It's in our  
16 investigative files. Under the rules of discovery for  
17 administrative proceedings they are not entitled to that.  
18 They will get at least a report of this evidence as we  
19 proceed to hearing, and it's an exhibit. And evidence  
20 related to the Ponzi scheme will also be produced.

21 As far as waiting 30 days to, why don't you  
22 just issue an order now, once you read our response, and  
23 you'll see that the rules are very clear, there's no gray  
24 areas here. The rules are explicit on how discovery is to  
25 be conducted in an administrative proceeding, and they're

1 just -- they're stuck on civil rules of discovery.  
2 They're demanding things that they're not entitled to. So  
3 I think you would at least consider the different  
4 positions.

5 ALJ STERN: I'm not going to order anything  
6 instantly, Mr. Palfai, rest easy. I assume also, when  
7 you're referring to this as an investigative matter by the  
8 Division, you're referring to the Commission, of course;  
9 right? The Division being an extension of the Commission?

10 MR. PALFAI: Correct.

11 ALJ STERN: Which under the rule that  
12 Mr. Galbut provided me with, R14-3-101 reads at the end of  
13 the first paragraph: Notwithstanding any of the above,  
14 neither these rules nor the Rules of Civil Procedure shall  
15 apply to any investigation by the Commission, any of its  
16 divisions, or its Staff.

17 So...

18 MR. GALBUT: It's an investigation, Your  
19 Honor. We're not in an investigation, we're in a  
20 proceeding.

21 ALJ STERN: You're in an investigation. I  
22 believe Mr. Palfai will verify that fact.

23 MR. GALBUT: Absolutely false. This is an  
24 administrative proceeding. We're not in an investigation.  
25 That investigation takes place before. He tried to use

1 investigative techniques in this. We are in an  
2 administrative proceeding which is governed by the rules  
3 of administrative procedure. It is an incorrect statement  
4 to say we were in an investigation. That is an inaccurate  
5 statement as a matter of law, and Your Honor, that is not  
6 a correct statement of what we are.

7           What Mr. Palfai just said, it's incredible to  
8 me what had just happened. He said that we're not  
9 entitled to this information on the Ponzi scheme, which he  
10 has alleged here for the first time today, because it's an  
11 investigative matter. Your Honor, he just said two  
12 minutes ago that they have evidence, and I'd like -- at  
13 some point, maybe the court reporter has to read it back,  
14 he says they have evidence of a Ponzi scheme. We're  
15 entitled to evidence that he has.

16           And Your Honor, I would respectfully submit  
17 again that we are not getting due process if the court  
18 does not order this minute that he turn over the evidence  
19 which he has so boldly proclaimed to this court, Your  
20 Honor, this is not an investigation, this is an  
21 administrative proceeding. We have rights here. We want  
22 those rights respected.

23           Thank you, Your Honor.

24           ALJ STERN: Thank you.

25           Mr. Roshka.

1 MR. ROSHKA: Mr. Stern, just to add,  
2 obviously, there are rules regarding investigations, and  
3 as I've always read 101, that last sentence, it's to avoid  
4 any conflict between the rules that apply to  
5 investigations prior to a proceeding. I believe the  
6 distinction Mr. Galbut made, which is once a proceeding is  
7 commenced, those rules no longer can be used to shelter  
8 the information collected by the Division. Obviously, the  
9 rules of investigations, if they would apply, we would  
10 only be allowed to take notes and not even question  
11 witnesses. We're in a proceeding and we have the rights  
12 that we've all been talking about today.

13 ALJ STERN: I don't disagree with you, but I  
14 know that the Division -- and I'll let Mr. Palfai clarify  
15 this. What's the Division's position, Mr. Palfai?

16 MR. PALFAI: There's an enormous amount of  
17 case law that confirms that investigations can continue  
18 after filing an administrative action. There's no doubt  
19 on that issue, and I'll be happy to provide you with reams  
20 of paperwork.

21 ALJ STERN: I've heard that argument before.  
22 I've come down this path a few times I think, Mr. Roshka,  
23 you and I did with some case a while ago. I don't  
24 remember which one, but it was one of them.

25 It's always argued that once we start the

1 hearing process, the investigation stops. But I know that  
2 the Division, and this, it's an ongoing investigation.  
3 It's like the city never sleeps or something.

4 MS. YINGLING: Your Honor, may I interject  
5 something?

6 ALJ STERN: Yes, ma'am.

7 MS. YINGLING: I completely understand. I  
8 respect the Division's privilege. However, that privilege  
9 cannot be used essentially once it is waived. By  
10 Mr. Palfai coming in today and professing over and over  
11 again that he has evidence of a Ponzi scheme, and further  
12 that he expects to submit that evidence at the final  
13 hearing of this matter, any investigatory privilege that  
14 would have attached to that evidence, assuming there was  
15 such a privilege in the first instance, has now been  
16 waived, so he -- whether the privilege applied in the  
17 first instance is now irrelevant, because he has  
18 ostensibly used it and repeatedly stated to Your Honor  
19 that he had this evidence. That privilege no longer  
20 exists.

21 ALJ STERN: Okay. Well, I'll expect to see  
22 that in your reply, because I know in his objections I  
23 guess he's going to include whatever objections he has.  
24 So we'll see.

25 As I said, I'm not going to make any rulings



1 on this particular matter right now. I'm going to wait  
2 and see what the objections are, I'm going to wait and see  
3 what the response is, and any reply by the Division, I'll  
4 make a ruling. We will be getting much closer to who  
5 witnesses are going to be and what exhibits are going to  
6 be in a fairly short time.

7 So with that, if there's nothing further, we  
8 can end this proceeding today, and I'll expect to see what  
9 the Division's situation is by tomorrow, and then I'll  
10 look forward to hearing from the respondents.

11 Anything further?

12 MR. PALFAI: I would just urge the court to  
13 keep in mind the fact that many investors have invested  
14 quite a large sum of money in this case, and it is the  
15 Division's duty to protect those investors, and part of  
16 that protection in this instance requires a quick  
17 adjudication of this matter.

18 ALJ STERN: Okay.

19 MR. GALBUT: Your Honor, I was going to say  
20 nothing, but in light of the comment, I would hope that  
21 Mr. Palfai would at least one day bring one investor here  
22 who's been hurt or provide Your Honor with the name of one  
23 of them, that would be helpful, so instead of his speaking  
24 in the abstract maybe we could have some particulars.

25 Nothing else, Your Honor.



1 ALJ STERN: Mr. Roshka, anything?

2 MR. ROSHKA: No, sir, I'm done.

3 ALJ STERN: Mr. Galbraith.

4 MR. GALBRAITH: Me, too.

5 ALJ STERN: Thank you. That concludes today's  
6 proceedings. I want to see the briefs, then we'll get  
7 going. Thank you.

8 (The prehearing conference concluded at  
9 11:20 a.m.)

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 STATE OF ARIZONA )  
2 ) ss.  
3 COUNTY OF MARICOPA )  
4  
5  
6

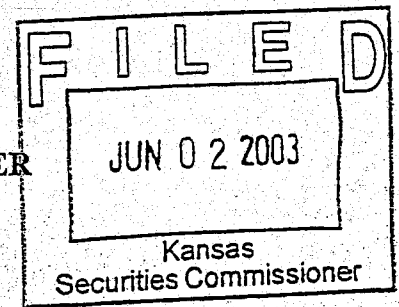
7 I, CECELIA BROOKMAN, Certified Court Reporter  
8 No. 50154 for the State of Arizona, do hereby certify that  
9 the foregoing printed pages constitute a full, true and  
10 accurate transcript of the proceedings had in the  
11 foregoing matter, all done to the best of my skill and  
12 ability.

13  
14 WITNESS my hand this 9th day of March, 2004.  
15  
16  
17  
18  
19  
20

21 \_\_\_\_\_  
CECELIA BROOKMAN, RPR  
22 Certified Court Reporter  
23 Certificate No. 50154  
24  
25

## **EXHIBIT 2**

BEFORE THE SECURITIES COMMISSIONER  
OF THE STATE OF KANSAS



In the matter of:

CARL R. TODD,

Respondent.

Docket No. 03E054  
K.S.C.# 2003-4723

A proceeding pursuant to K. S. A. 17-1266a.

NOTICE OF INTENT TO INVOKE ADMINISTRATIVE SANCTIONS  
UNDER THE KANSAS SECURITIES ACT

The Securities Commissioner of Kansas finds that sufficient evidence exists to provide cause under K.S.A. 17-1266a to invoke administrative sanctions against the respondent under the Kansas Securities Act. If the facts alleged below are found to be true, through either administrative adjudication, failure of the respondent to make a timely request for hearing, or default of the respondent, it is the intention of the Commissioner to enter an Order imposing Sanctions upon the respondent. Such sanctions may include, *inter alia*, a fine up to \$5,000 per violation, and/or Permanent Cease and Desist Order.

If the respondent wishes to contest the facts alleged below, or offer evidence and argument to mitigate those facts, then he must file a request for hearing within 30 days of service of this notice. The request for hearing must be in the manner and form prescribed by K.A.R. 81-11-5, and it must be filed with the Office of the Securities Commissioner, 618 S. Kansas Avenue, Topeka, Kansas 66603. The request for hearing must be verified under oath by the respondent, and if the respondent disputes any of the facts alleged below, he shall specifically deny those facts or they will be deemed admitted by the respondent. If the facts alleged are properly disputed, a hearing officer will be appointed and the matter will be set for hearing. If no request

for hearing is filed within 30 days after service of this Notice, the Commissioner will issue a final Order without further proceedings.

#### ALLEGATIONS OF FACT

1. Respondent Carl R. Todd ("Todd") is a Missouri resident whose address is 16704 Bradley Ave., Belton, MO. 64012.
2. On March 20, 2003, the Kansas Securities Commissioner's office received an inquiry from a known Kansas resident. The Kansas resident requested information regarding Southwest Income Management Inc. ("SIM") and Carl Todd, a representative of SIM.
3. The Kansas resident reported that Todd contacted him at the request of his relatives who had previously invested in Todd's investment program. Todd met with the known Kansas resident at his Kansas home on or about March 15, 2003. Todd presented an investment opportunity; the Equity Sales Program ("ESP") purported to be a program offered through SIM, the company he was representing.
4. Documents supplied by Todd to the Kansas resident described ESP as follows : " The Equity Sales Program simply is a program in which an owner of residential property mortgages their property (residential home or rental property) up to 80% at very low interest start rates of 1.95% to 3.5% and invests that money in a Universal Lease paying up to 11%. The profit of 5% or more can be paid out monthly, quarterly, annually or held to accumulate tax deferred."
5. The Universal Lease Program ("ULP") was described by Todd as a federally copyrighted investment program that involved gas and mineral leases, resorts, auto manufacturing, restaurants, rental car agencies, hotels, timeshares and nightclubs.

6. The money from the investor obtained through the Equity Sales Program would be invested into the Universal Lease Program with an income stream of 9% or more. The Universal Lease Program is managed by Resort Holdings International ("RHI") at 3222 Mishawaka Ave., South Bend, IN.
7. Resort Holdings International is a Nevada corporation. The address for RHI is the same as for the Illinois based corporation Yucatan Resorts S.A. ("Yucatan"). RHI is an authorized representative of Yucatan. Yucatan and its principal officer, Michael Kelley, have been subject to various administrative orders.
8. Actions taken against Yucatan include a Cease and Desist Order issued by New Mexico Securities Division, Order No. 99-99-015-208 (CD), May 18, 1999. A Petition for Order was filed against Yucatan by the State of Wisconsin, Department of Financial Institutions, Division of Securities, File No. S-00031 (EX), March 28, 2001. The Office of the Attorney General, Securities Division, for the State of South Carolina filed a Cease and Desist Order against Yucatan, Case No. 99040, June 14, 1999. The State of Pennsylvania, Securities Division, has a current action against Yucatan, 2002-10-33.
9. On March 25, 2003, The Kansas Securities Commissioners Office sent a Letter of Inquiry to respondent Todd and to Southwest Income Management Inc. by certified mail requesting details of the investment program.
10. RHI and Todd responded to the Kansas Securities Commissioner through counsel representing RHI and Todd. RHI acknowledged that SIM and Todd were authorized agents of RHI and Yucatan.
11. RHI was supplied copies of the Equity Sales Program offered by Todd. RHI advised that the ESP offered by Todd was not a program authorized by RHI, Yucatan or SIM, as a product

sold under their program. RHI said they offered timeshares in Mexico in resorts held by Yucatan. RHI acknowledged that the program Todd offered was a security.

12. RHI acknowledged that Yucatan had been subject to regulatory action by other states for investment programs they had previously offered. RHI stated that the programs were no longer offered by RHI. The only program authorized for sale by Yucatan and its agents was the timeshares in Mexican resorts, held by Yucatan.
13. Based on the information regarding the Equity Sales Program offered by Todd, RHI advised that his employment was terminated on May 13, 2003.
14. Respondent Todd failed to inform the Kansas investor that the Equity Sales Program was not an authorized product of SIM, RHI or Yucatan.
15. Respondent Todd is not registered as a broker-dealer or agent for the sale of securities in Kansas.
16. The investment opportunity offered by respondent Todd was not registered with the Kansas Securities Commissioner.

#### ALLEGATIONS OF LAW

17. The investment opportunity offered to the investor is an investment contract and is therefore a security as defined by K.S.A. 17-1252(j).
18. Respondent's failure to inform the Kansas investor that the Equity Sales Program was not an authorized product of Yucatan Resorts S.A., Resort Holdings International Inc. or Southwest Income Management Inc., was an omission of material fact, in connection with the offer of the security in violation of K.S.A. 17-1253.



19. Respondent Todd engaged in business as a broker-dealer in Kansas without registration in violation of K.S.A. 17-1254(a).

20. Respondent Todd offered to sell unregistered securities in Kansas, in violation of K.S.A. 17-1255.

Entered at Topeka, Shawnee County, Kansas, this 2 day of June, 2003.

*David R. Brant*

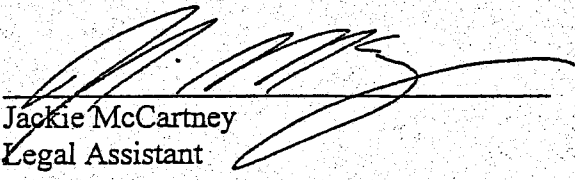
DAVID R. BRANT  
Securities Commissioner  
State of Kansas

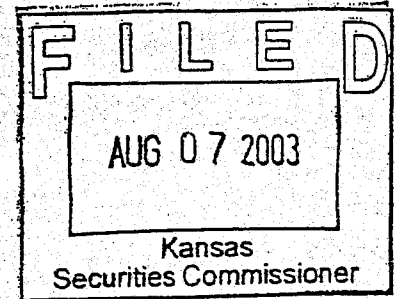


CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of June, 2003, copies of the Notice of Intent to Invoke Administrative Sanctions Under the Kansas Securities Act, Docket No 03E033 in the matter of Ronald D. Freund, Respondent, was mailed by certified mail, return receipt requested, addressed to the following:

Carl R. Todd  
16704 Bradley Ave.  
Belton, MO. 64012

  
\_\_\_\_\_  
Jackie McCartney  
Legal Assistant

BEFORE THE SECURITIES COMMISSIONER  
OF THE STATE OF KANSAS

In the matter of:

CARL R. TODD,

Docket No. 03E054  
KSC# 2003-4723

Respondent.

/  
A proceeding pursuant to K. S. A. 17-1266a.STIPULATION FOR CONSENT ORDER

This proceeding follows an investigation conducted by the Office of the Securities Commissioner of Kansas. As a result of this investigation, on June 2, 2003, the Commissioner issued a Notice of Intent to Invoke Administrative Sanctions Under the Kansas Securities Act. The attached Notice contains allegation of fact and conclusions of law in 20 separate paragraphs. These allegations are incorporated by reference.

Respondent Carl R. Todd, wishing to obtain a disposition of the above referenced matter without invoking his right to a hearing, has determined not to contest the issuance of the attached Consent Order based on the above referenced allegations.

IT IS, THEREFORE, STIPULATED AND AGREED by and between Respondent Carl R. Todd, and the staff of the Office of the Kansas Securities Commissioner that:

1. The attached Consent Order may be issued by the Securities Commissioner of Kansas without further proceedings.
2. The attached Consent Order shall constitute neither an admission nor a denial that the allegations serving as a basis for the Order are true.

3. Respondent waives his right to any hearing prior to issuance of the attached Consent Order on the basis of the referenced allegations.
4. Respondent Carl R. Todd shall file an affidavit stating that he has made no sales of the securities referenced in the Notice in the State of Kansas.

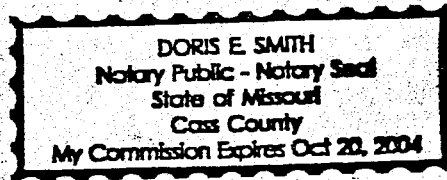
Approved:

Carl R. Todd  
Carl R. Todd

7/14/03  
Date

This instrument was signed before me on this 14<sup>th</sup> day of July, 2003  
2003, by Carl R. Todd.

(seal)



Doris E. Smith  
Notary Public

My appointment expires: 10-20-04

Office of the Securities Commissioner of Kansas

Wiley B. Kannarr  
Wiley B. Kannarr  
Associate General Counsel

8-7-03  
Date

STATE OF MISSOURI)

)ss.

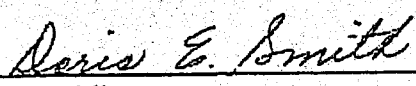
COUNTY OF CASS)

1. My name is Carl R. Todd.
2. This affidavit is provided pursuant to the Stipulation for Consent Order, In the matter of Carl R. Todd, Docket No. 03E054, before the Securities Commissioner of the State of Kansas.
3. I have not made any sales of the securities subject to the Notice of Intent in this action in the state of Kansas.

FURTHER, AFFIANT SAITH NAUGHT.

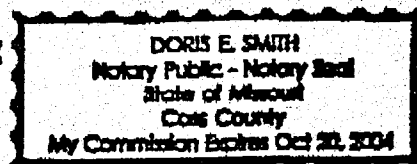
  
\_\_\_\_\_  
Carl R. Todd

Subscribed and sworn to before me this 4th day of August, 2003.

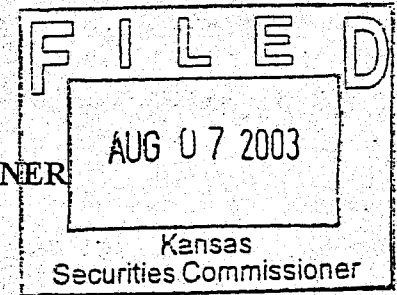
  
\_\_\_\_\_  
Notary Public

My Commission Expires:

10/20/04

August 4, 2003  
DATE

BEFORE THE SECURITIES COMMISSIONER  
OF THE STATE OF KANSAS



In the matter of:

CARL R. TODD,

Docket No. 03E054  
KSC# 2003-4723

Respondent.

/   
A proceeding pursuant to K. S. A. 17-1266a.

CONSENT ORDER

Whereas, pursuant to the attached Stipulation for Consent Order, it has been stipulated and agreed by and between Respondent Carl R. Todd and the staff of the Office of the Securities Commissioner of Kansas that this Order may be issued without further proceedings in this matter; and

Whereas, it has been further stipulated and agreed that by subscribing to the Stipulation for Consent Order, respondent neither admits nor denies that the staff allegations are true; and

Whereas, by the attached Stipulation for Consent Order, respondent has waived his right to a hearing before the Commissioner or his designee with respect to the issuance of this Order and the allegations set forth in the Stipulation for Consent Order.

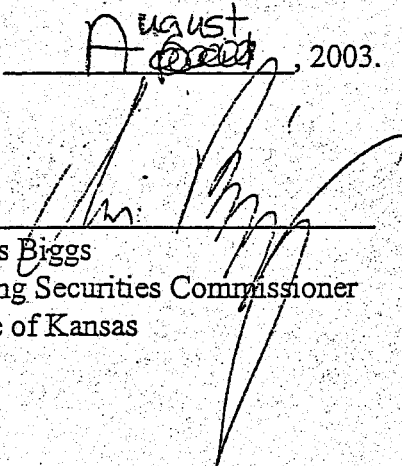
IT IS, THEREFORE, ORDERED by the Commissioner that Respondent Carl R. Todd and his officers, agents, servants, employees, and any person in concert or participation with him who receives actual notice of this order, shall immediately CEASE AND DESIST from (1) transacting business in the State of Kansas as a broker-dealer or agent, as defined in K.S.A. 17-1252, unless the persons engaged in such business are

registered under the Kansas Securities Act or exempt from registration; (2) offering or selling any security in the State of Kansas unless the security is registered under the Kansas Securities Act or exempt from registration; and (3) engaging in any other acts or practices which constitute violations of the Kansas Securities Act.

Thomas Clough, District Director of the National Association of Securities Dealers, 120 West 12<sup>th</sup> Street, Suite 900, Kansas City, Missouri 64105-1902, has been given notice of this proceeding.

IT IS SO ORDERED BY THE COMMISSIONER.

Entered at Topeka, Kansas, this 7<sup>th</sup> day of August, 2003.

  
Chris Biggs  
Acting Securities Commissioner  
State of Kansas

**NOTICES:**

- (1) Pursuant to K.S.A. 17-1267(a), an intentional violation of an Order issued under the Kansas Securities Act is a felony criminal offense.
- (2) This decision may constitute final agency action that is subject to judicial review. The agency officer to receive service of a petition for judicial review on behalf of the Office of the Securities Commissioner is David R. Brant, Securities Commissioner, at 618 South Kansas Avenue, Topeka, Kansas 66603.

## **EXHIBIT 3**



BEFORE THE  
STATE OF WISCONSIN  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
DIVISION OF SECURITIES

---

In the Matter of  
YUCATAN RESORTS, S.A., de C.V.,

Respondent.

ORDER OF PROHIBITION  
(CONSENT)

File No. S-00031(EX)

---

Based upon the attached Petition for Order and Waiver and Consent to Order I find that this action is necessary and appropriate in the public interest and for the protection of investors;

Therefore, pursuant to sec. 551.63, Wis. Stats.;

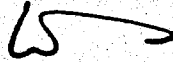
IT IS ORDERED THAT:

- a. Yucatan Resorts, S.A. de C.V., its successors, affiliates, controlling persons, officers, agents, servants, employees, and every entity and person directly or indirectly controlled or organized by or on its behalf, are prohibited from making or causing to be made to any person or entity in Wisconsin any further offers or sales its securities unless and until such securities are registered under Ch. 551, Wis. Stats., or successor statute or otherwise exempted therefrom.
- b. Yucatan Resorts, S.A. de C.V., its successors, affiliates, controlling persons, officers, agents, servants, employees, and every entity and person directly or indirectly controlled or hereafter organized by or on its behalf, are prohibited from violating sec. 551.41, Wis. Stats., or successor statute.
- c. Yucatan Resorts, S.A. de C.V., its successors, affiliates, controlling persons, officers, agents, servants, employees, and every entity and person directly or indirectly controlled or hereafter organized by or on its behalf, are prohibited from employing an agent to represent them in Wisconsin unless the agent is licensed under Ch. 551, Wis. Stats., or successor statute, or excepted from the licensing requirement.
- d. The administrator, upon a showing of good cause, has determined that it is not necessary under the circumstances that this order be grounds for disqualification pursuant to sec. 551.23(19), Wis. Stats. or that any exemption previously claimed by Yucatan Resorts S.A. de C.V. be denied.
- e. The Summary Order of Prohibition and Revocation issued against Yucatan Resorts SA de CV on April 2, 2001 is hereby revoked.



EXECUTED at Madison, Wisconsin, this 4th day of April, 2003.

(SEAL)



Patricia D. Struck  
Administrator  
Division of Securities

NOTICE:

You are advised that any wilful violation of an Order issued by the Administrator of the Division of Securities of the State of Wisconsin Department of Financial Institutions under Ch. 551, Wis. Stats., is a criminal offense punishable under the provisions of sec. 551.58, Wis. Stats.

BEFORE THE  
DIVISION OF SECURITIES  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
STATE OF WISCONSIN

In the Matter of  
YUCATAN RESORTS, S.A. de C.V. and  
MICHAEL E. KELLY,

PETITION FOR ORDER

Respondents.

File No. S-00031(EX)

The staff of the Enforcement Unit, Registration & Enforcement Section, of the Division of Securities, Department of Financial Institutions, State of Wisconsin has conducted an investigation in this matter pursuant to sec. 551.56, Wis. Stats. and as a result thereof alleges as follows:

1. Yucatan Resorts, S.A., de C.V. ("Yucatan SA") is a business with last known business addresses of Boulevard Kukulcan KM. 11.5, Cancun, Quintana Roo, Mexico 77500, and C1. 50 y Aquilino De La Guardia, Edificio American International Mezanine, Panama Centro, Panama.
2. Michael E. Kelly ("Kelly") is an individual, who is the owner, operator and sole shareholder of Yucatan SA, with a last known business address at that of Yucatan SA.
3. Upon information and belief, during the period of at least 2000, an agent of Yucatan SA, offered and sold to at least one person in Wisconsin an interest in the Yucatan SA Universal Lease Program ("the Program"), in which the investor purchases, for a minimum of \$5000, a lease of a unit at Club Baccara Exclusive Vacation Resort.
4. According to marketing materials provided to investors in the Program, investors have three options concerning the operation of their unit, one of which is to "Hire a third party servicing agent to rent the vacation unit for you (the investor). This popular option will result in paying you the equivalent of 11% per year of the amount you paid for your Universal Lease." and that "In fact, as a Leaseholder, you have the option to redeem your Universal Lease for the full purchase price or higher after two years."
5. According to the "Universal Lease Servicing Agreement" ("the Agreement") entered into between the Wisconsin investor ("the Client") in the Program and the servicing agent, World Phantasy Tours, Inc. DBA Viajes Majesty ("the Servicer"), signed on January 23, 2000, Paragraphs 1 and 3 of the Agreement states, in part, as follows:

"1.(b) The Servicer shall have full power and authority to do things in connection with such servicing, administration and collection activities which it may deem necessary or desirable in order to maximize the Rental. ... Client shall furnish the Servicer with powers of attorney and other documents necessary or appropriate as required by the Servicer to enable the Servicer to carry out its servicing and administrative duties hereunder."

"3.(a) The Servicer guarantees rental of the vacation unit at 80% of the Resorts published rack rates. ... Upon such satisfaction in full, the Servicer shall be entitled to a Servicing Fee of 40% of amounts collected from the rental of the Vacation Unit or a minimum of \$435.00 per year of amounts collected from the rental of the Unit. ..."

6. Upon information and belief, the investment in the Program was an investment in a common enterprise with the expectation of profit to be derived through the essential managerial efforts of someone other than the investor.
7. The Yucatan SA investments as described above are investment contract securities as that term is defined by DFI-Sec 1.02(6)(a), Wis. Adm. Code and are therefore securities pursuant to sec. 551.02(13)(a), Wis. Stats.,
8. The investment contract securities of Yucatan SA have never been registered for offer and sale in Wisconsin pursuant to Ch. 551, Wis. Stats.
9. Yucatan has violated sec. 551.21(1), Wis. Stats., by offering and selling unregistered securities in Wisconsin.
10. At no time has the Yucatan agent been licensed as a securities agent to sell the securities of Yucatan SA pursuant to Ch. 551, Wis. Stats.
11. Yucatan has violated sec. 551.31(2), Wis. Stats., by employing an unlicensed agent to represent them in Wisconsin.
12. Upon information and belief, Yucatan Investment Corporation ("Yucatan Investment"), was the subject of an administrative order of the New Mexico Securities Division on May 18, 1999, for the sale of unregistered, non-exempt securities by unlicensed agents of nine-month notes of Yucatan Investment.
13. Upon information and belief, Yucatan Investment was the subject of an administrative order of the South Carolina Securities Division on July 26, 1999, for the sale of unregistered, non-exempt securities by unlicensed agents of nine-month notes of Yucatan Investment, and in violation of the anti-fraud provision of the South Carolina securities law.
14. Upon information and belief, Yucatan Investment is a business entity related to Yucatan SA and is also owned and operated by Kelly.
15. Upon information and belief, money invested in the Program of Yucatan SA was used, in part, to repay investment in nine-month notes sold of Yucatan Investment.
16. Upon information and belief, during the offers and sales of the securities of Yucatan SA in the Program to a person in Wisconsin, as described above, Yucatan SA, failed to inform the person in Wisconsin of the administrative order issued by the South Carolina Division of Securities against Yucatan Investment and of the misuse of the money invested by the person.
17. By engaging in the conduct as described above, Yucatan SA, in connection with the offer and sale of a security to a person in Wisconsin, as set forth above, omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, in violation of sec. 551.41(2), Wis. Stats.
18. This Petition and the attached Orders are meant to replace the Petition of Order and the Summary Orders of Prohibition and Revocation that were issued against the Respondents on April 2, 2001.

Therefore, the staff of the Bureau of Registration and Enforcement petitions the Administrator of the Division of Securities for the issuance of the attached Order pursuant to Ch. 551, Wis. Stats.

Mark E. Dorman 3.25.03  
Mark E. Dorman Date  
Examiner  
Enforcement Unit

med

David A. Cohen 3/24/03  
David A. Cohen Date  
Supervising Attorney  
Enforcement Unit

BEFORE THE  
DIVISION OF SECURITIES  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
STATE OF WISCONSIN

In the Matter of  
YUCATAN RESORTS, S.A. de C.V.,  
Respondent.

WAIVER AND CONSENT TO  
ORDER

File No. S-00031(EX)

The undersigned Respondent, neither admitting nor denying the allegations contained in the staff's Petition for Order, and having decided not to contest the issuance of the attached Order, hereby waives its right to hearing with respect to this matter and hereby consents to the issuance of the Order;

The undersigned Respondent understands that the Order is effective when signed by the Administrator of the Division of Securities and that a willful violation of an Order signed by the Administrator is a criminal offense.

EXECUTED this 12 day of MARCH 2003.

YUCATAN RESORTS, S.A. DE C.V.

By

Michael E. Kelly - President  
(Type name and title)

Legal Representative

State of ST JOSEPH )  
County of INDIANA )

Subscribed before me this

12 day of MARCH 2003

Rhonda Meek  
Notary Public

My commission expires 23 JUNE 03

**EXHIBIT 4**

**STATE OF MINNESOTA  
COMMISSIONER OF COMMERCE**

In the Matter of Resort Holdings International, Inc.  
Resort Holdings International, S.A.  
and Terry C. Denny

**CONSENT CEASE AND  
DESIST ORDER**

Commissioner of Commerce Glenn Wilson (hereinafter "Commissioner") has determined as follows:

1. The Commissioner has advised counsel for Resort Holdings International, Inc., Resort Holdings International, S.A and Terry C. Denny (hereinafter "Respondents") that he is prepared to commence formal action pursuant to Minn. Stat. § 45.027, subd. 5 (2002) against Respondents based on allegations that Respondents:
  - a) Offered or sold unregistered securities in the form of investment contracts in vacation property management programs associated with leases in violation of Minn. Stat. Chap. 80A (2002) or
  - b) offered or sold subdivided land without registration under Minn. Stat. Chap. 83 (2002) and,
  - c) with respect to Terry C. Denny, offered or sold securities or subdivided land without licensure under Minn. Stat. § 80A.04 or Minn. Stat. Chap. 82 (2002), as applicable.
2. Respondents acknowledge that they have been advised of their rights to a hearing in this matter, to present argument to the Commissioner and to appeal from any adverse determination after a hearing, and Respondents hereby expressly waive those rights. Respondents further acknowledge that they have been represented by legal counsel throughout these proceedings, or have been advised of their right to be represented by legal counsel, which right they hereby waive.



3. Respondents have agreed to informal disposition of this matter without a hearing as provided under Minn. Stat. § 14.59 (2002) and Minn. R. 1400.5900 (2001) and further agreed to entry of this Order without admitting or denying the allegations specified in paragraph 1 above.

4. The following Order is in the public interest.

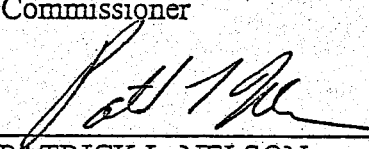
**NOW, THEREFORE, IT IS HEREBY ORDERED**, that pursuant to Minn. Stat. § 45.027, subd. 5 (2002) Respondents shall cease and desist from offering or selling in the state of Minnesota the above-described or any other securities and/or subdivided land until compliance with Minn. Stat. Chaps. 80A or 82 and 83 (2002), as applicable, with respect to any future transaction, have been achieved and that nothing in this Order shall be construed to serve as a basis for denying registration under either of the aforementioned applicable statutes.

This Order shall be effective upon signature on behalf of the Commissioner.

Dated: 2/12/03

Glenn Wilson  
Commissioner

By:

  
PATRICK L. NELSON  
Deputy Commissioner  
Market Assurance

85 Seventh Place East, Suite 500  
Saint Paul, Minnesota 55101  
Telephone: (651) 296-4051



## CONSENT TO ENTRY OF ORDER

The undersigned, acting on behalf of Resort Holdings International, Inc. and Resort Holdings International, S.A. (collectively "RHI"), states that he has read the foregoing Consent Order; that he knows and fully understands its contents and effect; that he is authorized to execute this Consent to Entry of Order on behalf of RHI; that he has been advised of RHI's right to a hearing; that RHI has been represented by legal counsel in this matter; or that he has been advised of RHI's right to be represented by legal counsel and that he has waived this right; and that he consents, without admitting or denying the allegations specified in the Consent Cease and Desist Order, to entry of the foregoing Order by the Commissioner of Commerce. It is further expressly understood that the foregoing Order constitutes the entire settlement agreement between the parties hereto, there being no other promises or agreements, either express or implied.

RESORT HOLDINGS INTERNATIONAL, INC.  
and RESORT HOLDINGS, S.A.

By:

  
MICHAEL E. KELLY

Its:

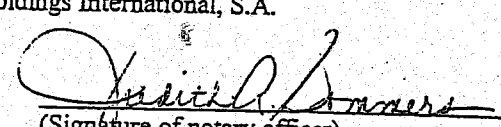
President

STATE OF Indiana

COUNTY OF Madison

This instrument was acknowledged before me on February 4, 2003 (date) by Michael E. Kelly as President of Resort Holdings International, Inc. and Resort Holdings International, S.A.

(stamp)

  
(Signature of notary officer)

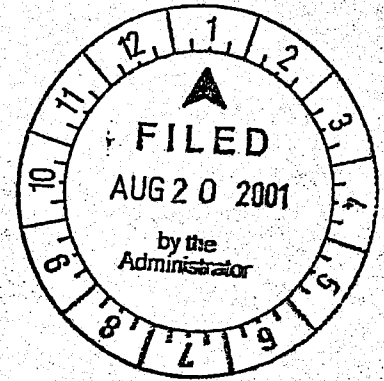
Notary Public  
Title (and Rank)

My commission Expires: 11/27/07

Hancock County Resident

## **EXHIBIT 5**

STATE OF OKLAHOMA  
DEPARTMENT OF SECURITIES  
THE FIRST NATIONAL CENTER, SUITE 860  
120 NORTH ROBINSON  
OKLAHOMA CITY, OKLAHOMA 73102



In the Matter of:

Yucatan Resorts, Southwest Income  
Management and Larry Mack,

Respondents.

ODS File No. 02-030

**ORDER INITIATING INVESTIGATION**

It has come to the attention of the Administrator of the Oklahoma Department of Securities (Department) that the referenced Respondents may be involved in the offer or sale of securities in the state of Oklahoma. The information concerning the alleged activities of the referenced Respondents indicates that such persons or entities may have violated certain sections of the Oklahoma Securities Act (Act), Okla. Stat. tit. 71, §§ 1-413, 501, 701-703 (1991 and Supp. 2000), and/or the Rules of the Oklahoma Securities Commission and the Administrator of the Department of Securities (Rules).

Section 405 of the Securities Act provides in part:

(a) The Administrator in his discretion:

(1) may make such public or private investigations within or outside of this state as he deems necessary to determine whether any person has violated or is about to violate any provision of this Act or any rule or order hereunder, or to aid in the enforcement of this act or in the prescribing of rules and forms hereunder;

(2) may require or permit any person to file a statement in writing, under oath or otherwise as the Administrator determines, as to all the facts and circumstances concerning the matter to be investigated; and

(b) For the purpose of any investigation or proceeding under this act, the Administrator, or his or her designee, may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, agreements, or other documents or records deemed relevant or material to the inquiry[.]

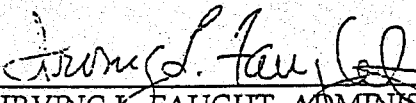
Based upon the information received and in light of the provisions of the Securities Act, the Administrator has determined it to be in the public interest to conduct an investigation into the activities of the referenced Respondents.

IT IS THEREFORE ORDERED that an investigation be commenced by the Department into the activities of the referenced Respondents or associated or affiliated entities or individuals, to determine whether such persons have violated or are continuing to violate any provision of the Securities Act or the Rules. Such investigation shall be conducted pursuant to Section 405 of the Securities Act.

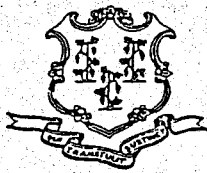
If the Administrator determines that violations of the Securities Act and/or Rules have occurred, the Administrator may pursue any of the courses of action set forth in the Act or as otherwise authorized by law. If, however, the facts indicate that no corrective action by the Administrator is warranted, the investigation will be closed.

20<sup>th</sup> Witness my Hand and the Official Seal of the Oklahoma Department of Securities this day of August, 2001.

(SEAL)

  
IRVING L. FAUGHT, ADMINISTRATOR OF THE  
OKLAHOMA DEPARTMENT OF SECURITIES

**EXHIBIT 6**



STATE OF CONNECTICUT  
DEPARTMENT OF BANKING

260 CONSTITUTION PLAZA • HARTFORD, CT 06103-1800



John P. Burke  
Commissioner

\*\*\*\*\*  
IN THE MATTER OF:  
YUCATAN INVESTMENT CORP.  
("Respondent")  
\*\*\*\*\*

ORDER TO CEASE AND DESIST  
NOTICE OF INTENT TO FINE  
AND  
NOTICE OF RIGHT TO HEARING  
DOCKET NO. CF-2000-6133-S

I. PRELIMINARY STATEMENT

1. The Banking Commissioner (the "Commissioner") is charged with the administration of Chapter 672a of the Connecticut General Statutes, the Connecticut Uniform Securities Act (the "Act") and the regulations promulgated thereunder (Sections 36b-31-2 to 36b-31-33, inclusive, of the Regulations of Connecticut State Agencies) (the "Regulations").

2. Pursuant to Section 36b-26(a) of the Act, the Commissioner, through the Securities and Business Investments Division (the "Division") of the Department of Banking, has conducted an investigation into the activities of Respondent to determine if it has violated, is violating, or is about to violate provisions of the Act or Regulations. Section 36b-26(a) of the Act provides, in pertinent part:

The commissioner, in his discretion, may, subject to the provisions of the Freedom of Information Act . . . (1) Make such public or private investigations within or outside of this state as he deems necessary to determine whether any person has violated or is about to violate any provision of sections 36b-2 to 36b-33, inclusive, or any regulation or order thereunder . . .

3. As a result of the investigation by the Division, the Commissioner has authority to issue a cease and desist order against Respondent pursuant to Section 36b-27(a) of the Act, as amended by Public Act 99-38, which provides, in pertinent part:

Whenever it appears to the commissioner after an investigation that any person or persons have violated, are violating or are about to violate any of the provisions of sections 36b-2 to 36b-33, inclusive . . . or that the further sale or offer to sell securities would constitute a violation of said sections . . . the commissioner may in his discretion order the person or persons to cease and desist from the violations of the provisions of said sections . . . or from the further sale or offer to sell securities constituting or which would constitute a violation of the provisions of said sections . . . . After such an order is issued, the person or persons named therein may, within fourteen days after receipt of the order, file a written request for a hearing. Said hearing shall be held in accordance with the provisions of chapter 54.

4. As a result of the investigation conducted by the Division, the Commissioner has the authority to impose a fine on Respondent pursuant to Section 36b-27(d) of the Act, as amended by Public Act 99-38, which provides, in pertinent part:

(1) Whenever the commissioner finds as the result of an investigation that any person or persons have violated any of the provisions of sections 36b-2 to 36b-33, inclusive, . . . the commissioner may send a notice to such person or persons by registered mail, return receipt requested. Any such notice shall include: (A) A reference to the title, chapter, regulation, rule or order alleged to have been violated; (B) a short and plain statement of the matter asserted or charged; (C) the maximum fine that may be imposed for such violation; and (D) the time and place for the hearing. Such hearing shall be fixed for a date not earlier than fourteen days after the notice is mailed.

(2) The commissioner shall hold a hearing upon the charges made unless such person or persons fail to appear at the hearing. Said hearing shall be held in accordance with the provisions of chapter 54. After the hearing if the commissioner finds that the person or persons have violated any of the provisions of sections 36b-2 to 36b-33, inclusive . . . the commissioner may, in his discretion and in addition to any other remedy authorized by said sections, order that a fine not exceeding ten thousand dollars per violation be imposed upon such person or persons. If such person or persons fail to appear at the hearing, the commissioner may, as the facts require, order that a fine not exceeding ten thousand dollars per violation be imposed upon such person or persons. The commissioner shall send a copy of any order issued pursuant to this subsection by registered mail, return receipt requested, to any person or persons named in such order.



## II. RESPONDENT

5. Respondent is a corporation with its principal place of business at 711 South Michigan Street, LaPaz, Indiana 46537.

## III. STATEMENT OF FACTS

6. From at least August 1998 to the present, Respondent was the issuer of securities in the form of promissory notes (the "Yucatan Notes").

7. From at least August 1998 to the present, Respondent employed at least one agent who, on behalf of Respondent, offered and sold the Yucatan Notes to at least two Connecticut customers. At no time was such agent registered in Connecticut under the Act as an agent of Respondent.

8. The Yucatan Notes offered and sold by Respondent through its agent were never registered in Connecticut under Section 36b-16 of the Act, nor were they exempt from registration under Section 36b-21 of the Act, as amended by Public Act 99-38, nor were they covered securities.

## IV. STATUTORY BASES FOR ORDER TO CEASE AND DESIST AND ORDER IMPOSING FINE AGAINST RESPONDENT

### a. Violation of Section 36b-6(b) of the Act – Employment of an Unregistered Agent by an Issuer

9. Paragraphs 1 through 8, inclusive, are incorporated and made a part hereof as if more fully set forth herein.

10. Respondent employed at least one unregistered agent who offered and sold the Yucatan Notes to at least two Connecticut customers, as more fully described in paragraph 7, in violation of Section 36b-6(b) of the Act, which constitutes a basis for an order to cease and desist to be issued against Respondent under Section 36b-27(a) of the Act, as amended, and for the imposition of a fine against Respondent under Section 36b-27(d) of the Act, as amended.



b. Violation of Section 36b-16 of the Act – Sale of Unregistered Securities by an Issuer

11. Paragraphs 1 through 10, inclusive, are incorporated and made a part hereof as if more fully set forth herein.

12. Respondent offered and sold the Yucatan Notes to at least two Connecticut customers, as more fully described in paragraph 7, which notes were not registered in Connecticut under the Act, as more fully described in paragraph 8. The offer and sale of such securities absent registration was in violation of Section 36b-16 of the Act, which constitutes a basis for an order to cease and desist to be issued against Respondent under Section 36b-27(a) of the Act, as amended, and for the imposition of a fine against Respondent under Section 36b-27(d) of the Act, as amended.

**V. ORDER TO CEASE AND DESIST AND NOTICE OF RIGHT TO HEARING**

**AS A RESULT OF THE INVESTIGATION BY THE DIVISION, THE COMMISSIONER FINDS** that, with respect to the activity described herein, Yucatan Investment Corp. has violated Sections 36b-6(b) and 36b-16 of the Act;

**THE COMMISSIONER FURTHER FINDS** that the issuance of this Order is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policies and provisions of the Act.

**THE COMMISSIONER THEREFORE ORDERS** that Yucatan Investment Corp. **CEASE AND DESIST** from directly or indirectly violating the provisions of the Act, including without limitation:

(1) employing unregistered agents, and (2) offering and selling unregistered securities;

**THE COMMISSIONER FURTHER ORDERS** that, pursuant to Section 36b-27(a) of the Act, as amended, Respondent will be afforded an opportunity for a hearing on the allegations set forth above.

A hearing will be granted to Respondent if a written request for a hearing is received by the Department of Banking, Legal Division, 260 Constitution Plaza, Hartford, Connecticut 06103-1800 within fourteen (14) days following its receipt of this Order. The enclosed Appearance and Request for

Hearing Form must be completed and mailed to the above address. If you will not be represented by an attorney at the hearing, please complete the Appearance and Request for Hearing Form as "pro se." If a hearing is requested, the hearing will be held on December 27, 2000, at 10 a.m., at the Department of Banking, 260 Constitution Plaza, Hartford, Connecticut.

The hearing will be held in accordance with the provisions of Chapter 54 of the Connecticut General Statutes. At such hearing, Respondent will have the right to appear and present evidence, rebuttal evidence and argument on all issues of fact and law to be considered by the Commissioner. Once a written request for a hearing is received, the Commissioner shall issue a notice of hearing at least fourteen (14) days prior to a hearing in accordance with Section 4-177 of the Connecticut General Statutes and Section 36-1-17(c) of the Regulations of Connecticut State Agencies.

This Order shall remain in effect and become permanent if Respondent does not request a hearing within the prescribed time period.

#### **VI. NOTICE OF INTENT TO FINE RESPONDENT AND NOTICE OF HEARING**

**WHEREAS**, the Commissioner finds as a result of an investigation by the Division that Respondent has violated Sections 36b-6(b) and 36b-16 of the Act;

**WHEREAS**, the Commissioner believes that the imposition of a fine upon Respondent would be in the public interest and consistent with the purposes fairly intended by the policy and provisions of the Act;

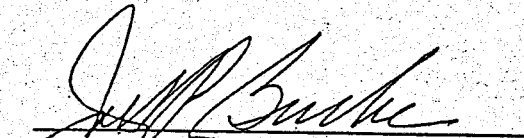
**AND WHEREAS**, notice is hereby given to Respondent that the Commissioner intends to impose a fine not to exceed Ten Thousand Dollars (\$10,000) per violation or a maximum fine of Twenty Thousand Dollars (\$20,000).

**NOW THEREFORE**, a hearing will be held in accordance with Section 36b-27(d)(2) of the Act, as amended, and Chapter 54 of the Connecticut General Statutes.

The hearing will be held on December 27, 2000, at 10 a.m., at the Department of Banking,  
260 Constitution Plaza, Hartford, Connecticut.

At the hearing, Respondent will have the right to appear and present evidence, rebuttal evidence  
and argument on all issues of fact and law relating to the allegations stated herein. If Respondent fails to  
appear at such hearing, the Commissioner may order that the maximum fine be imposed upon  
Respondent.

Dated at Hartford, Connecticut  
this 17<sup>th</sup> day of November 2000.

  
\_\_\_\_\_  
John P. Burke  
Banking Commissioner

**EXHIBIT 7**

1. Respondent Yucatan Investment Corporation ("YUCATAN"), whose last known address was 711 S. Michigan Street, P.O. Box 312, Lapaz, Indiana 46537, is a corporation organized under the laws of the State of Indiana, and was at all times relevant hereto, doing business in New Mexico.
2. Respondent Michael E. Kelly ("KELLY"), whose last known address was 711 S. Michigan Street, P.O. Box 312, Lapaz, Indiana 46537, was at all times relevant hereto, the chairman, corporate executive officer and director of Respondent YUCATAN.
3. Respondent Gary Van Waeyenberghe ("WAEYENBERGHE"), whose last known address was 711 S. Michigan Street, P.O. Box 312, Lapaz, Indiana 46537, was at all times relevant hereto, the director of the North American investment office of Respondent YUCATAN.

4. Respondent American Financial Group, LLC ("AFG"), whose last known address was 133 Eubank Blvd., NE, Albuquerque, New Mexico 87123, is a Limited Liability Company organized under the laws of New Mexico and was at all times relevant hereto, doing business in New Mexico.
5. Respondent Angelo Garcia ("GARCIA"), whose last known address was 133 Eubank Blvd, NE, Albuquerque, New Mexico 87123, was at all times relevant hereto, an organizer, equity owner and principal of Respondent AFG.
6. Respondent Thomas Straub ("STRAUB") whose last known address was 133 Eubank Blvd, NE, Albuquerque, New Mexico 87123, was at all times relevant hereto, an employee of Respondents AFG and GARCIA.
7. From January 1, 1998 through May 10, 1999 inclusive, Respondents AFG, GARCIA and STRAUB, acting through and/or on behalf of Respondent YUCATAN, offered for sale and/or sold certain "High Interest 9 Month Commercial Promissory Notes" (the "NOTES"), issued or to be issued by Respondent YUCATAN, to various New Mexico residents.
8. The NOTES are "securities" as that term is defined by Section 58-13B-2(X) of the New Mexico Securities Act of 1986 (the "Act") and are therefore subject to the provisions of the Act.
9. The NOTES were not registered under the provisions of the Act, and no exemption from registration was claimed or available in the offer and/or sale of the NOTES. Therefore, the offer to sell and/or the sale of the NOTES, as set forth in Paragraph 7 above, were in violation of Section 58-13B-20 of the Act.
10. In effecting the offer for sale and/or the sale of the NOTES, as set forth above, Respondents AFG, GARCIA and STRAUB were acting through and/or on behalf of Respondent YUCATAN as "sales representatives" as that term is defined in Section 58-13B-2(V) of the Act.



11. Respondents AFG, GARCIA and STRAUB were not licensed as sales representatives under the provisions of the Act, nor were they exempt from such licensure, and therefore their acts in the offering for sale and/or selling the NOTES as set forth in Paragraph 7 above, constitute violations of Section 58-13B-3 of the Act.
12. From January 1, 1998 through May 10, 1999, inclusive, Respondents YUCATAN, KELLY and WAEYENBERGHE acting as principals and/or agents of Respondent YUCATAN, offered for sale and/or sold through Respondents AFG, GARCIA and STRAUB securities which were neither registered under the Act nor exempt from registration, and thus violated Sections 58-13B-3 and 58-13B-20 of the Act.
13. Purchasers of securities sold by the Respondents are entitled to notification of their rights under the Act, and that such securities sales may be rescinded by the purchasers at their election, and that Respondents must offer to repurchase the security for cash equal to the consideration paid plus interest at the legal rate of this state from the date of payment until the date of rescission, plus attorney's fees as provided by Sections 58-13B-40 and 58-13B-42 of the Act.
14. Entry of this Order is in the public interest, appropriate for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of the Act.

**IT IS, THEREFORE, ORDERED THAT:**

15. Respondents shall cease and desist offering to sell or selling the NOTES or any other securities of any kind in New Mexico without first complying with all provisions of the Act.
16. Respondents shall, within fifteen (15) days of receipt of this Order, provide the Director with a list of all persons in the State of New Mexico who were offered and/or sold the NOTES or other securities of any type from Respondents. The list shall consist of the full name, address, social security number, telephone number,

date solicited, type of security purchased, name of soliciting agent, and total investment for each person.

16. Pursuant to Section 58-13B-53 of the Act, Notice of Opportunity for Hearing will be sent certified mail, return receipt requested, advising that a hearing will be granted on this Order upon written request timely filed with the Director and, in default of such request, that this Order, and the proposed Order immediately following, shall become Final. Respondents' request for such hearing must be received by the Director within fifteen (15) days after Respondents' receipt of this Order.

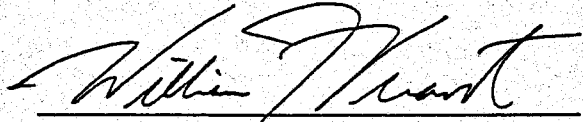
**FURTHER, THE DIRECTOR PROPOSES TO ORDER THAT:**

17. In the event that the Director enters a Final Order including a conclusion of law that the Respondents have violated one or more of the Sections and Subsections of the Act enumerated in Section 58-13B-40(A) of the Act, or one or more of the rules promulgated under such Sections and Subsections, then the Respondents shall, within fifteen (15) days of receipt of a copy of such Final Order, notify all purchasers of their rights as outlined in Paragraph 13 of this Order. Prior to notifying the purchasers, the Respondents shall submit to the Director the written notice that Respondents intend to give to purchasers. Respondents shall, within thirty (30) days from the entry of such Final Order, provide the Director with documentation showing that the purchasers have been notified of their right of rescission. Such documentation may be in the form of a U.S. Postal Service Receipt for Certified Mail, PS Form 3800. No later than thirty-five (35) days after each purchaser has acknowledged receipt of the rescission offer, Respondents shall provide the Director with a copy of each purchaser's reply to the rescission offer. In the absence of a reply from a purchaser, Respondents may submit adequate proof that the purchaser received the rescission offer and that thirty (30) days have elapsed since receipt thereof.



18. Pursuant to Section 58-13B-37 of the Act, further or alternative penalties be imposed upon Respondents in an amount to be determined after hearing.

ENTERED AT Santa Fe, New Mexico this 18<sup>3</sup> day of MAY 1999.

  
William J. Verant, Acting Director  
New Mexico Securities Division



# **EXHIBIT 8**

CERTIFIED TO BE A TRUE AND  
COPY AS TAKEN FROM AND COMPILED  
THE ORIGINAL ON FILE IN THIS OFFICE  
OF THE ATTORNEY GENERAL  
OF SOUTH CAROLINA  
2/23/04

STATE OF SOUTH CAROLINA  
OFFICE OF THE ATTORNEY GENERAL  
SECURITIES DIVISION

DATE \_\_\_\_\_  
IN THE MATTER OF: ) ADMINISTRATIVE PROCEEDING  
Michael E. Kelley and )  
Yucatan Investment Corporation ) ORDER TO CEASE AND DESIST FROM  
Respondents. ) OFFERING UNREGISTERED SECURITIES  
AND EMPLOYING UNREGISTERED AGENTS  
AND NOTICE OF RIGHT TO A HEARING  
Case No. 99040

The South Carolina Division of Securities (the "Division") under the authority of the South Carolina Uniform Securities Act (the "Act"), South Carolina Code Section 35-1-10, et seq., issues the following Order and notice of right to a public hearing.

1. Yucatan Investment Corporation ("Yucatan") is an Indiana corporation with a last known address of 711 South Michigan Street, Box 312, Lapaz, Indiana 46537. Yucatan is the issuer of the promissory notes involved in the present case, notes some of which were offered and sold in South Carolina.
2. Michael E. Kelly ("Kelly"), whose last known address is 711 South Michigan Street, Lapaz, Indiana 46537, served as President of Yucatan at all times material herein. All acts of Yucatan and its agents herein which are considered by the Division to be violations of the Uniform Securities Act occurred during Kelly's reign as President of Yucatan.
3. Yucatan and Kelly, through the use of "marketing firms," utilized agents to attract investments in Promissory Notes issued through Yucatan Investment Corporation.
4. During the time period January 27, 1998 to present, Yucatan and Kelly allowed at least nine agents to solicit investments in Yucatan promissory notes by South Carolina residents. The investments by South Carolina residents in the notes totaled in excess of \$800,000.00.
5. On or about February 25, 1999, Sean Helms ("Helms"), acting as agent for Greenmark Global Network Co., Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$47,410.00 and earning Helms a commission of approximately 15% of the investment.
6. On or about April 5, 1999, Bruce Rogers ("Rogers"), acting as agent for Greenmark Global Network Co., Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$33,750.00 and earning Rogers a commission of approximately 15% of the investment.

7. On or about April 7, 1999, Rogers, acting as agent for Greenmark Global Network Co., Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$10,000.00 and earning Rogers a commission of approximately 15% of the investment.
8. On or about August 1, 1998, Bob Salinas ("Salinas"), acting as agent for Forward Marketing, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$35,726.68 and earning Salinas a commission of approximately 15% of the investment.
9. On or about August 7, 1998, Salinas, acting as agent for Forward Marketing, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$42,645.95 and earning Salinas a commission of approximately 15% of the investment.
10. On or about February 14, 1999, Salinas, acting as agent for Forward Marketing, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$41,833.46 and earning Salinas a commission of approximately 15% of the investment.
11. On or about October 23, 1998, Walter Jacobs ("Jacobs"), acting as agent for Greenleaf, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$45,000.00 and earning Jacobs a commission of approximately 13.5% of the investment.
12. On or about January 18, 1999, Jacobs, acting as agent for Greenleaf, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$17,289.72 and earning Jacobs a commission of approximately 13.5% of the investment.
13. On or about June 9, 1998, Ferrell Davenport ("Davenport"), acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$20,000 and earning Davenport a commission of approximately 16% of the investment.
14. On or about January 27, 1998, Davenport, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$15,000.00 and earning Davenport a commission of approximately 16% of the investment.
15. On or about November 10, 1998, Davenport, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$25,000.00 and earning Davenport a commission of approximately 16% of the investment.

16. On or about August 20, 1998, Davenport, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$20,000.00 and earning Davenport a commission of approximately 16% of the investment.
17. On or about August 20, 1998, Davenport, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$5,000.00 and earning Davenport a commission of approximately 16% of the investment.
18. On or about December 1, 1998, John Patterson ("Patterson"), acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$33,945.08 and earning Patterson a commission of approximately 16% of the investment.
19. On or about May 6, 1998, Patterson, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$15,000.00 and earning Patterson a commission of approximately 16% of the investment.
20. On or about April 27, 1998, Patterson, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$50,000.00 and earning Patterson a commission of approximately 16% of the investment.
21. On or about February 23, 1999, Patterson, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$30,000.00 and earning Patterson a commission of approximately 16% of the investment.
22. On or about December 9, 1998, Patterson, acting as agent for Pinnacle, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$5323.75 and earning Patterson a commission of approximately 16% of the investment.
23. On or about December 9, 1998, Patterson, acting as agent for Pinnacle, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$5231.65 and earning Patterson a commission of approximately 16% of the investment.
24. On or about December 11, 1998, Patterson, acting as agent for Pinnacle, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$7611.09 and earning Patterson a commission of approximately 16% of the investment.

25. On or about February 23, 1999, Patterson, acting as agent for Pinnacle, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$30,000.00 and earning Patterson a commission of approximately 16% of the investment.
26. On or about September 15, 1998, Davenport, acting as agent for Summit Ridge, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$20,000.00 and earning Davenport a commission of approximately 16% of the investment.
27. On or about January 8, 1999, Samuel Small ("Small"), acting as agent for Greenmark, LLC, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$25,000.00 and earning Small a commission of approximately 15% of the investment.
28. On or about January 3, 1999, Ron Lucas ("Lucas"), acting as agent for Greenleaf, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$77,946.99 and earning Lucas a commission of approximately 15% of the investment.
29. On or about March 12, 1999, Jean Floyd ("Floyd"), acting as agent for Pinnacle, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$14,772.16 and earning Floyd a commission of approximately 16% of the investment.
30. On or about March 12, 1999, Floyd, acting as agent for Pinnacle, Yucatan and Kelly did successfully attract an investment by a South Carolina resident in a Yucatan note, such investment being in the amount of \$49,149.28 and earning Floyd a commission of approximately 16% of the investment.
31. The promissory notes constitute securities, as that term is defined by South Carolina Code Section 35-1-20(15).
32. The securities were not properly registered or exempt from registration prior to their offer and sale in this State.
33. At the time of the transactions above, neither Yucatan nor Kelly nor any of the agents who solicited on Yucatan and Kelly's behalf were licensed in South Carolina as a broker-dealer, broker-dealer agent, investment adviser, or investment adviser representative, authorized to transact business or to employ agents or other representatives to conduct securities business in this State.
34. When Respondents Yucatan and Kelly, through their agents, offered and sold the aforementioned unregistered securities to South Carolina residents, they did so in violation of both the agent and securities registration provisions of the Act.



35. When Respondents Yucatan and Kelly paid commissions to unregistered agents soliciting and selling on their behalf, they did so in violation of the securities registration provisions of the Act.

36. Respondents Yucatan and Kelly, further, individually and through their agents, and in connection with the offer and sale of the promissory notes, failed to inform the investors of various facts concerning their investments, including the facts: (1) none of the agents soliciting investments were properly registered to sell securities in this State, (2) the securities themselves were not properly registered for sale in this State, (3) the promissory notes could not be deemed to be very liquid, (4) agreeing to sign the notes carried with it a high degree of risk of loss of some or all of the investor's funds and (5) the agent soliciting the transactions received a commission totaling or in excess of 10% for obtaining the investment.

37. When Respondents Yucatan and Kelly omitted to disclose the material facts above, they violated South Carolina Code Section 35-1-1210 and committed securities fraud in this State against residents of the State.

38. Given the facts above, it is necessary and appropriate, in the public interest, for the protection of investors, and consistent with the purposes fairly intended by the policy and provisions of the Act to issue an Order revoking any applicable exemptions and demanding Respondents Yucatan and Kelly and any and all of their agents, assigns, or other persons working for or under them Cease and Desist from any future violations of the Act.

WHEREAS, the promissory notes described above constitute "securities" within the meaning of Section 35-1-20 (15) of the South Carolina Uniform Securities Act, Section 35-1-10, et. seq., Code of Laws of South Carolina; and

WHEREAS, the records of the Division disclose that the promissory notes are not now, nor have they ever been, registered under the Act, and

WHEREAS, Respondents Yucatan and Kelly employed agents to solicit and obtain investments in promissory notes issued by Yucatan; and

WHEREAS, the records of the Division show no broker-dealer, broker-dealer agent, investment adviser, or investment adviser representative registration for any of the agents so employed by Yucatan and Kelly; and

WHEREAS, based on the foregoing, the Division finds that Respondents Yucatan and Kelly have engaged in acts or practices which violate Sections 35-1-410 and 35-1-810 of the Act; and

WHEREAS, the Division further finds that Respondents Yucatan and Kelly, in connection with the offer and sale of the promissory notes in the State of South Carolina, omitted to state

material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, in violation of Section 35-1-1210 of the Act;

NOW, THEREFORE, IT IS ORDERED that Respondents Yucatan and Kelly, and every successor, affiliate, control person, agent, servant, or employee of each immediately CEASE AND DESIST from offering or selling securities in the State of South Carolina and from otherwise violating the Act, and in particular, Sections 35-1-410, 35-1-810, and 35-1-1210, thereof.

IT IS FURTHER ORDERED that any exemption that Respondents Yucatan, Kelly, or any successor, affiliate, control person, agent, servant, or employee of either, and every entity owned, operated, or indirectly or directly controlled or hereinafter organized by or on behalf of either of them might otherwise be entitled to utilize, be and hereby is REVOKED, subject only to the limitations provided in Section 35-1-330, Code of Laws of South Carolina.

Within thirty (30) days after receipt of written notification that this Order has been issued, Respondents may request that a hearing be held to consider rescinding the Order. To schedule such a hearing, Respondents must file a written request with Thresechia Navarro of the Securities Division, Post Office Box 11549, Columbia, South Carolina, 29211-1549.

The written request for a hearing should include, at a minimum, a statement of the specific reasons (including facts and provisions of the Act upon which the Respondent is relying) that support the request for a hearing to consider rescinding the Order.

Upon receipt of such written request for a hearing, the matter will be set down for a hearing within fifteen (15) days unless the person making the request consents to a later date.

So ORDERED this 14<sup>th</sup> day of June, 1999.

Charles M. Condon  
Securities Commissioner

By: Tracy A. Meyers  
Tracy A. Meyers  
Assistant Attorney General  
Securities Division  
Rembert C. Dennis Building  
1000 Assembly Street  
Columbia, S. C. 29201  
(803) 734-4731



CERTIFIED TO BE A TRUE AND CORRECT COPY AS THE ORIGINAL ON FILE IN THIS OFFICE  
THRESECHIA P. NAVARRO  
OF THE ATTORNEY GENERAL'S OFFICE  
OF SOUTH CAROLINA  
2/23/04

STATE OF SOUTH CAROLINA

OFFICE OF THE ATTORNEY GENERAL

SECURITIES DIVISION

DATE 2/23/04 IN THE MATTER OF:

Michael E. Kelly and  
Yucatan Investment Corporation

Respondents.

) ADMINISTRATIVE PROCEEDING

)  
) ADMINISTRATIVE CONSENT ORDER  
) BETWEEN RESPONDENT YUCATAN  
) INVESTMENT CORPORATION AND  
) THE SECURITIES DIVISION AND  
) RESPONDENT MICHAEL E. KELLY  
) AND THE SECURITIES DIVISION

) FILE NUMBER 99040

The South Carolina Securities Division (the "Division"), under authority of the South Carolina Uniform Securities Act, through use of the undersigned designee, and with consent of the Respondents specifically identified above as parties to this Order, hereby issues the following order.

1. In or around March 1999, the Division began conducting an investigation into a securities offering being conducted by and on behalf of Respondent Yucatan Investment Corporation ("Yucatan") as authorized by Section 35-1-1440, Code of Laws of South Carolina.
2. In the course of the investigation, the Division determined that Yucatan, relying on improper advice from prior counsel, offered and sold unregistered securities in violation of the South Carolina Uniform Securities Act.
3. Respondent Yucatan, further, employed unregistered sales agents to offer and sell such securities in South Carolina.
4. The violations the Division alleges occurred are detailed more specifically in the Order to Cease and Desist from Offering Unregistered Securities and Employing Unregistered Agents issued June 14, 1999 in this case, which is incorporated herein by reference.
5. At the time of the violations alleged, Respondent Michael E. Kelly ("Kelly") served as President of the corporation. In his position as President, Kelly was responsible for general oversight of the activities of Yucatan, including but not limited to selecting the marketing firms responsible for soliciting agents to conduct Yucatan's securities offering. Kelly, further, was the party responsible for obtaining counsel's approval to make the initial offering.
6. Following conversation with Respondent Yucatan, by and through its attorney, Jeffrey B. Bailey, Esquire, Securities Division Staff and Respondent Yucatan agree the most appropriate resolution of the matter is to impose upon Respondent Yucatan, who denies any wilful violation of law but desires to avoid the costs of a hearing and dispel any concerns of the Division, a \$20,000.00 fine and a requirement that the firm:

- a. Immediately cease and discontinue the offering of any type of security to South Carolina investors, and continue to cease and refrain from offering securities in this State unless or until any security to be offered is properly registered (to include notice filed) in this State,
  - b. immediately cease and permanently discontinue the practice of using unregistered paid sales agents to solicit business in South Carolina; and
  - c. refrain from renewing any maturing notes for any South Carolina resident unless or until the security being offered is registered with the State Securities Division or, if not applicable, the U.S. Securities & Exchange Commission ("the Commission").
7. The firm agrees it will pay the fine referenced above within five business days of the date of entry of this order.
8. Following conversation with Respondent Kelly, by and through his attorney, Jeffrey B. Bailey, Esquire, and following review of Kelly and Yucatan's response both to the Division's investigative request of April 29, 1999 and to continuing requests for more information, Securities Division Staff and Respondent Kelly agree to dismiss Kelly from the Cease and Desist Order issued June 14, 1999 in the present case, file number 99040.
9. Upon compliance with the requirements set forth above, this order represents the complete and final resolution of the investigation instituted and reflected as file number 99040 with respect to Respondents Yucatan and Kelly.
10. This Consent Order is issued in the Public Interest and for the protection of investors, consistent with the purpose of the Act.

Securities Division of the  
Office of the Attorney General of  
the State of South Carolina  
Rembert Dennis Building  
1000 Assembly Street  
Columbia, South Carolina 29202  
(803) 734-4731

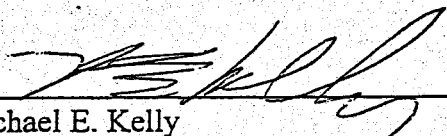
By: Tracy A. Meyers  
Tracy A. Meyers  
Assistant Attorney General

Columbia, South Carolina  
July 26, 1999

CONSENT TO ENTRY OF ORDER BY RESPONDENTS  
YUCATAN AND MICHAEL E. KELLY

Respondents Yucatan Investment Corporation and Michael E. Kelly hereby acknowledge that they have been served with a copy of this Order and the underlying Order to Cease and Desist Offering Securities and Employing Unregistered Agents, have read the foregoing, and are aware of their right to a hearing in this matter, and have waived same. Yucatan and Kelly admit the jurisdiction of the Division, and consent to entry of this Order, an order the Division finds to be in the public interest, specifically to resolve the Division's Cease and Desist Order issued June 14, 1999 in case number 99040.

Yucatan and Kelly state that no promise of any kind or nature whatsoever was made to induce them to enter into this Order and that they have entered into this Order voluntarily. Michael E. Kelly represents that he is President of Yucatan and that as such, has been authorized by Yucatan to enter into this Order for and on behalf of Yucatan.

  
\_\_\_\_\_  
Michael E. Kelly

(Individually and on behalf of Respondent Yucatan Investment Corporation)

7-22-99  
Date

## **EXHIBIT 9**

## Comment

[1] Dilatory practices bring the administration of justice into disrepute. Delay should not be indulged merely for the convenience of the advocates, or for the purpose of frustrating an opposing party's attempt to obtain rightful redress or repose. It is not a justification that similar conduct is often tolerated by the bench and bar. The question is whether a competent lawyer acting in good faith would regard the course of action as having some substantial purpose other than delay. Realizing financial or other benefit from otherwise improper delay in litigation is not a legitimate interest of the client.

### ER 3.3. Candor Toward the Tribunal

(a) A lawyer shall not knowingly:

(1) make a false statement of ~~material~~ fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

~~(2) except as required by applicable law, fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client;~~

~~(3)~~(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

~~(4)~~(3) ~~except as required by applicable law, offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.~~

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

~~(b)~~(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by ER 1.6.

~~(c) A lawyer may refuse to offer evidence that the lawyer reasonably believes is false.~~

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer which will enable the tribunal to make an informed decision, whether or not the facts are adverse.

### **Comment**

[1] This Rule governs the conduct of a lawyer who is representing a client in the proceedings of a tribunal. See ER 1.0(m) for the definition of "tribunal." It also applies when the lawyer is representing a client in an ancillary proceeding conducted pursuant to the tribunal's adjudicative authority, such as a deposition. Thus, for example, paragraph (a)(3) requires a lawyer to take reasonable remedial measures if the lawyer comes to know that a client who is testifying in a deposition has offered evidence that is false.

[2] ~~The advocate's task is~~ This Rule sets forth the special duties of lawyers as officers of the court to avoid conduct that undermines the integrity of the adjudicative process. A lawyer acting as an advocate in an adjudicative proceeding has an obligation to present the client's case with persuasive force. Performance of that duty while maintaining confidences of the client, however, is qualified by the advocate's duty of candor to the tribunal. However ~~Consequently, an advocate does although a lawyer in an adversary proceeding is not required to present an impartial exposition of the law or to vouch for the evidence submitted in a cause; the lawyer must not mislead the tribunal is responsible for assessing its probative value by false statements of law or fact or evidence that the lawyer knows to be false.~~

### **Representations by a Lawyer**

[3] An advocate is responsible for pleadings and other documents prepared for litigation, but is usually not required to have personal knowledge of matters asserted therein, for litigation documents ordinarily present assertions by the client, or by someone on the client's behalf, and not assertions by the lawyer. Compare ER 3.1. However, an assertion purporting to be on the lawyer's own knowledge, as in an affidavit by the lawyer or in a statement in open court, may properly be made only when the lawyer knows the assertion is true or believes it to be true on the basis of a reasonably diligent inquiry. There are circumstances where failure to make a disclosure is the equivalent of an affirmative misrepresentation. The obligation prescribed in ER 1.2(d) not to counsel a client to commit or assist the client in committing a fraud applies in litigation. Regarding compliance with ER 1.2(d), see ~~the comment~~ Comment [10] to that rule ~~Rule~~. See ~~also the Comment to~~ ER 8.4(b), Comment [2].

### **Misleading Legal Argument**

[4] Legal argument based on a knowingly false representation of law constitutes dishonesty toward the tribunal. A lawyer is not required to make a disinterested exposition of the law, but must recognize the existence of pertinent legal authorities. Furthermore, as stated in paragraph (a)(3)(2), an advocate has a duty to disclose directly adverse authority in the controlling jurisdiction which has not been disclosed by the opposing party. The underlying concept is that legal argument is a discussion seeking to determine the legal premises properly applicable to the case.



## **False-Offering Evidence**

~~When evidence that a lawyer knows to be false is provided by a person who is not the client, the lawyer must refuse to offer it regardless of the client's wishes.—~~

~~When false evidence is offered by the client, however, a conflict may arise between the lawyer's duty to keep the client's revelations confidential and the duty of candor to the court. Upon ascertaining that material evidence is false, the lawyer should seek to persuade the client that the evidence should not be offered, or, if it has been offered, that its false character should immediately be disclosed. If the persuasion is ineffective, the lawyer must take reasonable remedial measures.~~

~~The rule generally recognized is that, if necessary to rectify the situation, an advocate must disclose the existence of the client's deception to the court or to the other party. Such a disclosure can result in grave consequences to the client, including not only a sense of betrayal but also loss of the case and perhaps a prosecution for perjury. But the alternative is that the lawyer cooperate in deceiving the court, thereby subverting the truthfinding process which the adversary system is designed to implement. See ER 1.2(d). Furthermore, unless it is clearly understood that the lawyer will act upon the duty to disclose the existence of false evidence, the client can simply reject the lawyer's advice to reveal the false evidence and insist that the lawyer keep silent. Thus the client could in effect coerce the lawyer into being a party to fraud on the court.—~~

[5] Paragraph (a)(3) requires that the lawyer refuse to offer evidence that the lawyer knows to be false, regardless of the client's wishes. This duty is premised on the lawyer's obligation as an officer of the court to prevent the trier of fact from being misled by false evidence. A lawyer does not violate this Rule if the lawyer offers the evidence for the purpose of establishing its falsity.

[6] If a lawyer knows that the client intends to testify falsely or wants the lawyer to introduce false evidence, the lawyer should seek to persuade the client that the evidence should not be offered. If the persuasion is ineffective and the lawyer continues to represent the client, the lawyer must refuse to offer the false evidence. If only a portion of a witness's testimony will be false, the lawyer may call the witness to testify but may not elicit or otherwise permit the witness to present the testimony that the lawyer knows is false.

[7] The duties stated in paragraphs (a) and (b) apply to all lawyers, including defense counsel in criminal cases. In some jurisdictions, however, courts have required counsel to present the accused as a witness or to give a narrative statement if the accused so desires, even if counsel knows that the testimony or statement will be false. Counsel first must attempt to persuade the accused to testify truthfully or not at all. If the client persists, counsel must proceed in a manner consistent with the accused's constitutional rights. See *State v. Jefferson*, 126 Ariz. 341, 615 P.2d 638 (1980); *Lowery v. Cardwell*, 575 F.2d 727 (9<sup>th</sup> Cir. 1978). The obligation of the advocate under the Rules of Professional Conduct is subordinate to such constitutional requirements. See also Comment [9].

[8] The prohibition against offering false evidence only applies if the lawyer knows that the evidence is false. A lawyer's reasonable belief that evidence is false does not preclude its

presentation to the trier of fact. A lawyer's knowledge that evidence is false, however, can be inferred from the circumstances. See ER 1.0(f). Thus, although a lawyer should resolve doubts about the veracity of testimony or other evidence in favor of the client, the lawyer cannot ignore an obvious falsehood.

### **Refusing to Offer Proof Believed to be False**

[9] Generally speaking, Although paragraph (a)(3) only prohibits a lawyer has authority from offering evidence the lawyer knows to be false, it permits the lawyer to refuse to offer testimony or other proof that the lawyer reasonably believes is untrustworthy false. Offering such proof may reflect adversely on the lawyer's ability to discriminate in the quality of evidence and thus impair the lawyer's effectiveness as an advocate. In criminal cases, however, a lawyer may, in some jurisdictions, be denied this authority by constitutional requirements governing the right to counsel. Because of the special protections historically provided criminal defendants, however, this Rule does not permit a lawyer to refuse to offer the testimony of such a client where the lawyer reasonably believes but does not know that the testimony will be false. Unless the lawyer knows the testimony will be false, the lawyer must honor the client's decision to testify. See also Comment [7].

### **Perjury by a Criminal Defendant**

Whether an advocate for a criminally accused has the same duty of disclosure has been intensely debated. While it is agreed that the lawyer should seek to persuade the client to refrain from perjurious testimony, there has been dispute concerning the lawyer's duty when that persuasion fails. If the confrontation with the client occurs before trial, the lawyer ordinarily can withdraw. Withdrawal before trial may not be possible, however, either because trial is imminent, or because the confrontation with the client does not take place until the trial itself, or because no other counsel is available.

The most difficult situation, therefore, arises in a criminal case where the accused insists on testifying when the lawyer knows that the testimony is perjurious. The lawyer's effort to rectify the situation can increase the likelihood of the client's being convicted as well as opening the possibility of a prosecution for perjury. On the other hand, if the lawyer does not exercise control over the proof, the lawyer participates, although in a merely passive way, in deception of the court.

Three resolutions of this dilemma have been proposed. One is to permit the accused to testify by a narrative without guidance through the lawyer's questioning. This compromises both contending principles; it exempts the lawyer from the duty to disclose false evidence but subjects the client to an implicit disclosure of information imparted to counsel. Another suggested resolution, of relatively recent origin, is that the advocate be entirely excused from the duty to reveal perjury if the perjury is that of the client. This is a coherent solution but makes the advocate a knowing instrument of perjury.



~~The other resolution of the dilemma is that the lawyer must reveal the client's perjury if necessary to rectify the situation. A criminal accused has a right to the assistance of an advocate, a right to testify and a right of confidential communication with counsel. However, an accused should not have a right to assistance of counsel in committing perjury. Furthermore, an advocate has an obligation, not only in professional ethics but under the law as well, to avoid implication in the commission of perjury or other falsification of evidence. See ER 1.2(d).~~

~~Defense counsel's ethical options, as circumscribed by the criminal defendant's fundamental constitutional rights at trial, are still in the process of clarification. See, e.g., Lowery v. Cardwell, 575 F.2d 727 (9th Cir. 1978); State v. Jefferson, 126 Ariz. 341, 615 P.2d 638 (1980). Therefore, under the Arizona version of ER 3.3, the provisions of subparagraphs (a)(2) and (a)(4) are prefaced by the phrase "except as required by applicable law."~~

### Remedial Measures

[10] If perjured testimony or false evidence has been offered in the belief that it was true, a lawyer may subsequently come to know that the evidence is false. Or, a lawyer may be surprised when the lawyer's client or another witness called by the lawyer offers testimony the lawyer knows to be false, either during the lawyer's direct examination or in response to cross-examination by the opposing lawyer. In such situations or if the lawyer knows of the falsity of testimony elicited from the client during a deposition, the lawyer must take reasonable remedial measures. In such situations, the advocate's proper course ordinarily is to remonstrate with the client confidentially, advise the client of the lawyer's duty of candor to the tribunal and seek the client's cooperation with respect to the withdrawal or correction of the false statements or evidence. If that fails, the advocate should seek to withdraw if that will remedy the situation must take further remedial action. If withdrawal from the representation is not permitted or will not remedy the situation or is impossible undo the effect of the false evidence, the advocate should must make such disclosure to the court tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal information that otherwise would be protected by ER 1.6. It is for the court tribunal then to determine what should be done - making a statement about the matter to the trier of fact, ordering a mistrial or perhaps nothing. If the false testimony was that of the client, the client may controvert the lawyer's version of their communication when the lawyer discloses the situation to the court. If there is an issue whether the client has committed the perjury, the lawyer cannot represent the client in resolution of the issue, and a mistrial may be unavoidable. An unscrupulous client might in this way attempt to produce a series of mistrials and thus escape prosecution. However, a second such encounter could be construed as a deliberate abuse of the right to counsel and as such a waiver of the right to further representation.

[11] The disclosure of a client's false testimony can result in grave consequences to the client, including not only a sense of betrayal but also loss of the case and perhaps a prosecution for perjury. But the alternative is that the lawyer cooperate in deceiving the court, thereby subverting the truth-finding process which the adversary system is designed to implement. See ER 1.2(d). Furthermore, unless it is clearly understood that the lawyer will act upon the duty to disclose the

existence of false evidence, the client can simply reject the lawyer's advice to reveal the false evidence and insist that the lawyer keep silent. Thus, the client could in effect coerce the lawyer into being a party to fraud on the court.

### **Preserving Integrity of Adjudicative Process**

[12] Lawyers have a special obligation to protect a tribunal against criminal or fraudulent conduct that undermines the integrity of the adjudicative process, such as bribing, intimidating or otherwise unlawfully communicating with a witness, juror, court official or other participant in the proceeding, unlawfully destroying or concealing documents or other evidence or failing to disclose information to the tribunal when required by law to do so. Thus, paragraph (b) requires a lawyer to take reasonable remedial measures, including disclosure if necessary, whenever the lawyer knows that a person, including the lawyer's client, intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding.

### **Duration of Obligation**

[13] A practical time limit on the obligation to rectify the presentation of false evidence or false statements of law and fact has to be established. The conclusion of the proceeding is a reasonably definite point for the termination of the obligation. A proceeding has concluded within the meaning of this Rule when a final judgment in the proceeding has been affirmed on appeal or the time for review has passed.

### **Ex Parte Proceedings**

[14] Ordinarily, an advocate has the limited responsibility of presenting one side of the matters that a tribunal should consider in reaching a decision; the conflicting position is expected to be presented by the opposing party. However, in an ex parte proceeding, such as an application for a temporary restraining order, there is no balance of presentation by opposing advocates. The object of an ex parte proceeding is nevertheless to yield a substantially just result. The judge has an affirmative responsibility to accord the absent party just consideration. The lawyer for the represented party has the correlative duty to make disclosures of material facts known to the lawyer and that the lawyer reasonably believes are necessary to an informed decision.

### **Withdrawal**

[15] Normally, a lawyer's compliance with the duty of candor imposed by this Rule does not require that the lawyer withdraw from the representation of a client whose interests will be or have been adversely affected by the lawyer's disclosure. The lawyer may, however, be required by ER 1.16(a) to seek permission of the tribunal to withdraw if the lawyer's compliance with this Rule's duty of candor results in such an extreme deterioration of the client-lawyer relationship that the lawyer can no longer competently represent the client. Also see ER 1.16(b) for the circumstances in which a lawyer will be permitted to seek a tribunal's permission to withdraw. In connection with a request for permission to withdraw that is premised on a client's misconduct, a lawyer may

reveal information relating to the representation only to the extent reasonably necessary to comply with this Rule or as otherwise permitted by ER 1.6.

#### **ER 3.4. Fairness to Opposing Party and Counsel**

A lawyer shall not:

- (a) unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act;
- (b) falsify evidence, counsel or assist a witness to testify falsely, or offer an inducement to a witness that is prohibited by law;
- (c) knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on an assertion that no valid obligation exists;
- (d) in pretrial procedure, make a frivolous discovery request or fail to make reasonably diligent effort to comply with a legally proper discovery request by an opposing party;
- (e) in trial, allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence, assert personal knowledge of facts in issue except when testifying as a witness, or state a personal opinion as to the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused; or
- (f) request a person other than a client to refrain from voluntarily giving relevant information to another party unless:
  - (1) the person is a relative or an employee or other agent of a client; and
  - (2) the lawyer reasonably believes that the person's interests will not be adversely affected by refraining from giving such information.

#### **Comment**

[1] The procedure of the adversary system contemplates that the evidence in a case is to be marshaled competitively by the contending parties. Fair competition in the adversary system is secured by prohibitions against destruction or concealment of evidence, improperly influencing witnesses, obstructive tactics in discovery procedure, and the like.

[2] Documents and other items of evidence are often essential to establish a claim or defense. Subject to evidentiary privileges, the right of an opposing party, including the government, to obtain evidence through discovery or subpoena is an important procedural right. The exercise of that right can be frustrated if relevant material is altered, concealed or destroyed. Applicable law

in many jurisdictions makes it an offense to destroy material for purpose of impairing its availability in a pending proceeding or one whose commencement can be foreseen. Falsifying evidence is also generally a criminal offense. Paragraph (a) applies to evidentiary material generally, including computerized information. Applicable law may permit a lawyer to take temporary possession of physical evidence of client crimes for the purpose of conducting a limited examination that will not alter or destroy material characteristics of the evidence. In such a case, applicable law may require the lawyer to turn the evidence over to the police or other prosecuting authority, depending on the circumstances.

[3] With regard to paragraph (b), it is not improper to pay a witness's expenses or to compensate an expert witness on terms permitted by law. The common law rule in most jurisdictions is that it is improper to pay an occurrence witness any fee for testifying and that it is improper to pay an expert witness a contingent fee.

[4] Paragraph (f) permits a lawyer to advise employees of a client to refrain from giving information to another party, for the employees may identify their interests with those of the client. See also ER 4.2.

### **ER 3.5. Impartiality and Decorum of the Tribunal**

A lawyer shall not:

(a) seek to influence a judge, juror, prospective juror or ~~an other~~ official of a tribunal by means prohibited by law;

(b) communicate ex parte with such a person ~~except as permitted~~ during the proceeding unless authorized to do so by law or court order;

(c) communicate with a juror or prospective juror after discharge of the jury if:

(1) the communication is prohibited by law or court order;

(2) the juror has made known to the lawyer a desire not to communicate; or

(3) the communication involves misrepresentation, coercion, duress or harassment; or

~~(c)~~(d) engage in conduct ~~intended~~ likely to disrupt a tribunal.

### **Comment**

[1] Many forms of improper influence upon a tribunal are proscribed by criminal law. Others are specified in the ABA Model Code of Judicial Conduct, with which an advocate should be familiar. A lawyer is required to avoid contributing to a violation of such provisions.

misunderstanding on the part of the admissions or disciplinary authority of which the person involved becomes aware.

[2] This ~~rule~~ Rule is subject to the provisions of the Fifth Amendment of the United States Constitution and corresponding provisions of state constitutions. A person relying on such a provision in response to a question, however, should do so openly and not use the right of nondisclosure as a justification for failure to comply with this Rule.

[3] A lawyer representing an applicant for admission to the bar, or representing a lawyer who is the subject of a disciplinary inquiry or proceeding, is governed by the rules applicable to the client-lawyer relationship, including ER 1.6 and, in some cases, ER 3.3.

#### **ER 8.2. Judicial and Legal Officials**

(a) A lawyer shall not make a statement that the lawyer knows to be false or with reckless disregard as to its truth or falsity concerning the qualifications or integrity of a judge, adjudicatory officer or public legal officer, or of a candidate for election or appointment to judicial or legal office.

(b) A lawyer who is a candidate for judicial office shall comply with the applicable provisions of the ~~code~~ Code of judicial ~~Judicial~~ conduct ~~Conduct~~.

#### **Comment**

[1] Assessments by lawyers are relied on in evaluating the professional or personal fitness of persons being considered for election or appointment to judicial office and to public legal offices, such as attorney general, prosecuting attorney and public defender. Expressing honest and candid opinions on such matters contributes to improving the administration of justice. Conversely, false statements by a lawyer can unfairly undermine public confidence in the administration of justice.

[2] When a lawyer seeks judicial office, the lawyer should be bound by applicable limitations on political activity.

[3] To maintain the fair and independent administration of justice, lawyers are encouraged to continue traditional efforts to defend judges and courts unjustly criticized.

#### **ER 8.3. Reporting Professional Misconduct**

(a) A lawyer ~~having knowledge who knows~~ that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority, except as otherwise provided in these ~~rules~~ Rules or by law.

**EXHIBIT 10**



# Model Rules of Professional Conduct

## RULE 1.0 TERMINOLOGY

---

(a) "Belief" or "believes" denotes that the person involved actually supposed the fact in question to be true. A person's belief may be inferred from circumstances.

(b) "Confirmed in writing," when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (e) for the definition of "informed consent." If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

(c) "Firm" or "law firm" denotes a lawyer or lawyers in a law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or the legal department of a corporation or other organization.

(d) "Fraud" or "fraudulent" denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive.

(e) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

(f) "Knowingly," "known," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

(g) "Partner" denotes a member of a partnership, a shareholder in a law firm organized as a professional corporation, or a member of an association authorized to practice law.

(h) "Reasonable" or "reasonably" when used in relation to conduct by a lawyer denotes the conduct of a reasonably prudent and competent lawyer.

(i) "Reasonable belief" or "reasonably believes" when used in reference to a lawyer denotes that the lawyer believes the matter in question and that the circumstances are such that the belief is reasonable.

(j) "Reasonably should know" when used in reference to a lawyer denotes that a lawyer of reasonable prudence and competence would ascertain the matter in question.

(k) "Screened" denotes the isolation of a lawyer from any participation in a matter through the timely imposition of procedures within a firm that are reasonably adequate under the circumstances to protect information that the isolated lawyer is obligated to protect under these Rules or other law.

(l) "Substantial" when used in reference to degree or extent denotes a material



matter of clear and weighty importance.

(m) "Tribunal" denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.

(n) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including handwriting, typewriting, printing, photostating, photography, audio or videorecording and e-mail. A "signed" writing includes an electronic sound, symbol or process attached to or logically associated with a writing and executed or adopted by a person with the intent to sign the writing.

[Comment](#) | [Table of Contents](#)

# Model Rules of Professional Conduct

## *ADVOCATE* RULE 3.3 CANDOR TOWARD THE TRIBUNAL

---

**(a) A lawyer shall not knowingly:**

**(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;**

**(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or**

**(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.**

**(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.**

**(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.**

**(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.**

[Comment](#) | [Table of Contents](#)

# Model Rules of Professional Conduct

## ADVOCATE

### RULE 3.4 FAIRNESS TO OPPOSING PARTY AND COUNSEL

---

A lawyer shall not:

(a) unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act;

(b) falsify evidence, counsel or assist a witness to testify falsely, or offer an inducement to a witness that is prohibited by law;

(c) knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on an assertion that no valid obligation exists;

(d) in pretrial procedure, make a frivolous discovery request or fail to make reasonably diligent effort to comply with a legally proper discovery request by an opposing party;

(e) in trial, allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence, assert personal knowledge of facts in issue except when testifying as a witness, or state a personal opinion as to the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused; or

(f) request a person other than a client to refrain from voluntarily giving relevant information to another party unless:

(1) the person is a relative or an employee or other agent of a client; and

(2) the lawyer reasonably believes that the person's interests will not be adversely affected by refraining from giving such information.

[Comment](#) | [Table of Contents](#)

## Model Rules of Professional Conduct

### *ADVOCATE*

#### **RULE 3.5 IMPARTIALITY AND DECORUM OF THE TRIBUNAL**

---

A lawyer shall not:

(a) seek to influence a judge, juror, prospective juror or other official by means prohibited by law;

(b) communicate ex parte with such a person during the proceeding unless authorized to do so by law or court order;

(c) communicate with a juror or prospective juror after discharge of the jury if:

(1) the communication is prohibited by law or court order;

(2) the juror has made known to the lawyer a desire not to communicate; or

(3) the communication involves misrepresentation, coercion, duress or harassment; or

(d) engage in conduct intended to disrupt a tribunal.

[Comment](#) | [Table of Contents](#)

## Model Rules of Professional Conduct

### *ADVOCATE*

#### **RULE 3.9 ADVOCATE IN NONADJUDICATIVE PROCEEDINGS**

---

**A lawyer representing a client before a legislative body or administrative agency in a nonadjudicative proceeding shall disclose that the appearance is in a representative capacity and shall conform to the provisions of Rules 3.3(a) through (c), 3.4(a) through (c), and 3.5.**

[Comment](#) | [Table of Contents](#)